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South Carolina Legislative Audit Council

**LAC**

## Report to the General Assembly

October 1994

# A Performance Audit of the South Carolina Resources Authority Infrastructure Funding Program



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The Legislative Audit Council is composed of three public members, one of whom must be a practicing certified or licensed public accountant, and six General Assembly members who serve ex officio.

Audits by the Legislative Audit Council conform to generally accepted government auditing standards as set forth by the Comptroller General of the United States.

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*A Performance Audit of the South Carolina Resources Authority Infrastructure Funding Program was conducted by the following audit team.*

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# LAC

October 1994

## South Carolina Resources Authority Infrastructure Funding Program

**T**he Legislative Audit Council found problems with the South Carolina Resources Authority (SCRA) infrastructure funding program. Between 1989 and 1991, the SCRA (made up of the Budget and Control Board) issued approximately \$50 million in state bonds and used the funds to purchase local revenue bonds for 34 local water and wastewater projects. These bonds are often referred to as "moral obligation" bonds meaning the General Assembly may, but is not required to, use state funds to pay the debt when local governments are unable to make their debt payments.

### JEDA's Credit Analysis Criticized

The Jobs and Economic Development Authority (JEDA), came under criticism for its staffing role in the program. The LAC report states JEDA performed a "weak" credit analysis of bond applicants. They did not perform an independent analysis of revenue projections, which was vital to ensuring that bond debts could be paid. They did not properly evaluate the economic environment and other factors relevant to the borrowers' financial position, and did not adequately document the application process.

### Debt Not Monitored

The SCRA Act does not require that local governments be monitored. Without such monitoring, it is difficult for the state to intervene in a timely manner when a default seems likely. LAC's analysis of financial statements shows that eight of the borrowers may need to raise rates to avoid problems in repaying debt to the state. Projects were not monitored either during construction to ensure funds were used appropriately or after completion of construction to ensure that revenues were sufficient to pay the debt.

The General Assembly set aside more than \$1.2 million to assist some local governments with their payments; these bonds were supposed to be paid back to the state entirely from revenues produced by the local water and sewer systems. Additionally, the state has taken a junior position on approximately 70% of the debt. The SCRA bond payments are scheduled to run through the year 2021.

### Problems with Paying Bond Debt

One notable problem involved the town of New Ellenton, a small Aiken-county municipality of about 3,000 citizens. As the result of a series of problems, the town has defaulted on its \$5.025 million sewer bond. An engineering study found that the sewer system, as currently constructed, cannot support the number of users necessary to repay the debt. The state set aside \$425,000 in appropriated funds to assist New Ellenton in making its debt payments. The town's problems were caused by several factors, including over-stated revenue projections, diversion of the bond funds, and the eventual indictment of the mayor on state and federal charges.

Two other towns, Turbeville and Ridgeland, obtained revenue bonds and built sewer systems to accommodate new state prisons in their area. When they could not make their debt payments because the prisons failed to open on time, they received state funds totalling \$802,877.

### WRCC Failed to Use Agency Expertise

Several agencies that collectively had expertise in water/sewer financing, health, economic development, and bond programs were involved in the SCRA program. However, the Water Resources Coordinating Council (WRCC), which conducted



the program jointly with the Budget and Control Board, did not direct the bond approval process in a way that integrated and utilized experienced agency staff. The Water Resources Coordinating Council is composed of representatives from the departments of Health and Environmental Control, Natural Resources, and Commerce; the Division of Local Government; the Joint Bond Review Committee; and the Governor's office.

### Program Goals Not Met

Although the state's water and sewer needs will total over \$1 billion between 1990 and 2000, the program did not meet the goals set forth in the law. The law's stated intent was to promote the general health and welfare of all South Carolinians and to act as an incentive to foster economic growth, particularly in rural, less-developed areas of the state. However, the LAC found that, excluding the FMHA refinancings, only 42% of the projects funded were located in less-developed counties, none were in designated imminent health threat areas, and only 11% of the local borrowers were under a tap moratorium.

The Council identified several other factors which exacerbated the program's inability to meet its goals.

- WRCC did not fund applicants on the basis of the eight criteria set out in the law. No system for ranking applicants was adopted and WRCC approved all applicants JEDA brought before them.
- Instances were noted where WRCC took action by telephone poll rather than in a public meeting. This is a violation of the FOIA.
- The program was not marketed to applicants that most needed assistance, such as those in the rural, less-developed areas of the state.
- WRCC did not establish a formal procedure for coordinating funding from various sources. As a result, some applicants were approved for or received bond revenues when they could have obtained funding elsewhere.
- A lien position policy was not established to ensure that the SCRA was in the best position possible in case of default by borrowers.

### Outstanding SCRA Bonds

Participant	Issue Date	Amount Received
Aiken	Jun-90	\$1,965,000
Branchville	Apr-89	\$214,000
Dillon	Dec-91	\$1,615,000
Edgefield	Apr-89	\$1,848,000
Edgefield	Jun-90	\$1,165,000
Edisto	Apr-89	\$360,000
Edisto	Jun-90	\$460,000
Estill	Jun-90	\$3,390,000
Fort Mill	Dec-91	\$580,000
Georgetown	Apr-89	\$5,578,000
Georgetown	Jun-90	\$3,135,000
Hemingway	Apr-89	\$629,000
Isle of Palms	Dec-91	\$2,700,000
Lexington	Jun-90	\$2,525,000
McCormick	Jun-90	\$280,000
Mt. Pleasant	Jun-90	\$5,000,000
New Ellenton	Jun-90	\$5,025,000
Newberry	Dec-91	\$1,435,000
Pageland	Apr-89	\$1,367,000
Pageland	Dec-91	\$675,000
Ridgeland	Dec-91	\$650,000
Ridgeway	Apr-89	\$127,000
Saluda	Apr-89	\$922,000
Saluda	Jun-90	\$260,000
Santee	Apr-89	\$229,000
Santee	Jun-90	\$1,095,000
Summerton	Apr-89	\$99,000
Timmonsville	Apr-89	\$730,000
Turbeville	Jun-90	\$1,680,000
Varnville	Apr-89	\$333,000
Westminster	Apr-89	\$973,000
Williamston	Apr-89	\$941,000
Williston	Apr-89	\$123,000
Williston	Dec-91	\$285,000
<b>Total</b>		<b>\$48,393,000</b>

Amounts shown for participants in the 1989 issue do not include certain administrative costs totalling \$2,337,000.

Agency comments to the audit begin on page 45.

Copies of all LAC audits are available to the public at no charge. If you have additional questions, please contact George L. Schroeder, Director.

**LAC**

**Report to the General Assembly**

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**A Performance Audit  
of the South Carolina  
Resources Authority  
Infrastructure  
Funding Program**



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# Executive Summary

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Members of the General Assembly requested that we conduct a performance audit of the South Carolina Resources Authority (SCRA) Infrastructure Funding Program.

Between 1989 and 1991, the SCRA (composed of the members of the Budget and Control Board) issued over \$50 million in bonds to be used to fund local government water and wastewater projects. These bonds are often referred to as "moral obligation" bonds meaning the General Assembly may, but is not required to, use state funds to pay the debt when local governments are unable to make their debt payments. The SCRA bonds are scheduled to be repaid through the year 2021.

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We found that the state has committed more than \$1.2 million in state funds to assist SCRA borrowers in making their debt payments to the state, even though these bonds were supposed to be paid entirely from revenues produced by the local water or sewer system.

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The program was administered by a large group of state agencies, including the South Carolina Resources Authority (SCRA), The Water Resources Coordinating Council (WRCC) and The Jobs-Economic Development Authority (JEDA). These agencies collectively had expertise in water/sewer financing, health, economic development, and bond programs in general. The program was designed to function as an incentive to foster economic growth, particularly in rural, less-developed areas of the state. It has been estimated that the state's water and sewer needs will total over \$1 billion between the years 1990 and 2000.

Our review, however, found that the program did not meet the goals set forth in the law. We found that the state has committed more than \$1.2 million in state funds to assist SCRA borrowers in making their debt payments to the state, even though these bonds were supposed to be paid entirely from revenues produced by the local water or sewer system. For example, the town of New Ellenton, as the result of a series of problems, has defaulted on its bond. An engineering study has found that the sewer system cannot support the number of users necessary to repay the debt. The state has set aside \$425,000 in state funds to assist New Ellenton in making its debt payments.

Also, the towns of Turbeville and Ridgeland have received state funds totalling \$802,077 for 1993 and 1994 in order to enable them to make their debt service payments. In addition, our review found eight borrowers that were not in compliance with the debt service coverage requirements for either one or both years ending 1992 and 1993.

We identified several factors which contributed to the program's inability to meet its goals.

- JEDA's credit analysis of applicants was weak. JEDA did not perform an independent analysis of revenue projections, did not evaluate the economic environment and other factors relevant to the borrowers' financial position, and did not adequately document the application process (see p. 6).
- There was no monitoring of the projects either during construction to ensure funds were used appropriately or after completion of construction to ensure that revenues were sufficient to pay the debt (see p. 13).
- WRCC did not fund applicants on the basis of the eight criteria set out in the law. No system for ranking applicants was adopted and WRCC approved all applicants JEDA brought before them. Only 42% of the projects were located in less developed counties (see p. 26).
- We noted instances where WRCC took action by telephone poll rather than in a public meeting. This is a violation of the FOIA (see p. 27).
- WRCC did not create an approval process that fully integrated and utilized the collective knowledge of the member agencies (see p. 28).
- The program was not marketed to applicants that most needed assistance, such as those in the rural, less-developed areas of the state (see p. 31).
- WRCC did not establish a formal procedure for coordinating funding from various sources. As a result, some applicants were approved or received funding which could have obtained funding elsewhere (see p. 32).
- A lien position policy was not established to ensure that the SCRA was in the best position possible in case of default. Approximately 62% of SCRA's bonds are junior to other outstanding debt (see p. 33).

A bill passed by the General Assembly and signed by the Governor on October 5, 1994, will create a new infrastructure funding program to replace SCRA. This program will be administered by the Budget and Control Board (B&CB). For a more detailed discussion, see Chapter 4. Since the B&CB has the ultimate authority under both these programs, some of our recommendations are directed toward the B&CB.

# Introduction and Background

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## Audit Objectives

Members of the General Assembly requested that we conduct a performance audit of the Jobs-Economic Development Authority (JEDA) and its affiliated corporations. This report is a review of the South Carolina Resources Authority (SCRA) infrastructure funding program, and JEDA's role in this program. JEDA also administers loan and bond programs, which will be the subject of a second report.

A bill passed by the General Assembly and signed by the Governor, will create a new infrastructure funding program to replace the SCRA; this program will be administered by the South Carolina Budget and Control Board. Therefore, some of the recommendations of this first report are directed to the South Carolina Budget and Control Board and successor programs.

We conducted survey work at JEDA and the following agencies: Coordinating Council for Economic Development; Department of Commerce; Department of Health and Environmental Control; Division of Local Government of the Budget and Control Board; Office of the Governor; Joint Bond Review Committee; Office of the State Treasurer; and the Water Resources Commission. In consultation with audit requestors, we defined specific audit objectives which would allow us to evaluate the effectiveness of the program and make recommendations for improvements. The review focused on the following areas:

- The background and history of the infrastructure funding program including the role of all parties involved.
- The marketing, application and approval process for the program including evaluation of applications and criteria used in decision making.
- Oversight of the bond program including specific problems in payment of outstanding debt.

Concerns about the repayment of a 1990 revenue bond, issued to the town of New Ellenton for construction of a sewer system, led requestors to ask that we closely examine this issue. We have included in Chapter 2 a discussion of problems associated with the New Ellenton bond and other situations where local governments have not been financially able to meet their debt obligation. A description of the audit scope and methodology is found in Appendix A. A flow chart of the bond process is found in Appendix B. Appendix C contains a table of all SCRA bonds.

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## Background and History

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The law was intended to promote the general health and welfare of all South Carolinians and to act as an incentive to foster economic growth, particularly in the rural, less developed areas of the state.

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In 1981, a report by the Governor's Council on Rural Development found that many rural communities did not have access to adequate water and sewer services due to limited financial resources and inadequate coordination. The report recommended that the Governor help establish a program where smaller, rural communities could access the major bond markets, develop a regional approach for water and sewer projects, and coordinate funding and service borrowers. This may have provided an impetus for the SCRA program. Also, it was estimated the state's water and sewer needs would total over \$1 billion between the years 1990 and 2000.

The SCRA program was established by Act 682 of 1988, the South Carolina Resources Authority Act, that took effect on June 27, 1988. The program is a joint effort of SCRA and the Water Resources Coordinating Council (WRCC). JEDA is mandated to assist WRCC in its duties.

JEDA's role in the program is a "staffing" role in support of WRCC. The act mandates that JEDA "provide the staff to receive, research, investigate, and process applications . . . and assist in the formulating of priorities." JEDA is to be paid actual costs, not to exceed \$100,000 per fiscal year.

WRCC establishes the funding priorities for all sewer, wastewater treatment, and water supply facility projects funded under the act. The law was intended to promote the general health and welfare of all South Carolinians and to act as an incentive to foster economic growth, particularly in the rural, less developed areas of the state. The duties of WRCC are to: (1) establish procedures for receipt of applications; (2) in cooperation with SCRA, establish criteria for funding priorities; (3) provide to SCRA technical assistance from its respective agencies for purposes of screening funding applications; and (4) establish the project funding priorities.

The SCRA, composed of the South Carolina Budget and Control Board (B&CB), issued bonds under its name and used the revenue from the sale of its bonds to purchase individual bonds of local governments. The local governments in turn used the money to improve water and sewer infrastructure. Revenues generated by water/sewer plants are used to pay SCRA.

Projects were approved by WRCC and submitted to SCRA. The state treasurer must issue the bonds within 60 days of SCRA's acceptance of the list of recommendations from WRCC. To date, the program has issued, in three issues, over \$50 million in bonds: 1989 for \$16,810,000 [this was a refinancing of outstanding Farmer's Home Administration (FmHA) debt]; 1990 for \$25,980,000 and 1991 for \$7,940,000.

Combining local bonds under SCRA results in more favorable terms than would otherwise be available. The bonds are often referred to as "moral obligation" bonds, meaning the state may, but is not required to, appropriate funds to pay the local government's debt to prevent default. This reduces the risk to the investor and lowers the interest rate on the bonds.

SCRA's board is composed of the Governor as chairman, the state treasurer, the comptroller general, and chairmen of the Senate Finance Committee and the House Ways and Means Committee.

WRCC consists of:

- A representative of the Governor.
- The commissioner of the Department of Health and Environmental Control.
- The director of the South Carolina Department of Natural Resources (formerly the executive director of the Water Resources Commission).
- The director of the Division of Local Government of the Budget and Control Board.
- The director of the Department of Commerce (formerly the chairman of the Coordinating Council on Economic Development).
- The chairman of JEDA.
- The chairman of the Joint Bond Review Committee.

Originally, the chairmen of the House Ways and Means Committee and the Senate Finance Committee were also members of WRCC. However, these two members were removed from WRCC by a 1991 amendment. To date, the chairman of WRCC has always been the chairman of the Coordinating Council for Economic Development.

On June 2, 1994, the General Assembly ratified the South Carolina Infrastructure Facilities Act (Section 11-40-10, *et seq.* of the South Carolina Code of Laws), which was signed by the Governor on October 5, 1994. This act changes the program and sets up another organizational structure to handle local government infrastructure needs. The South Carolina Infrastructure Facilities Authority which, like SCRA, is composed of members of the South Carolina Budget and Control Board, is authorized to provide grants, loans, bonds and other forms of financial and technical assistance to local governments for infrastructure. The act designates the Division of Local Government to provide staff to assist the Infrastructure Facilities Authority in the administration of the program.

The new act provides for repeal of the SCRA act when all the bonds issued by SCRA are retired. SCRA's outstanding bonds are scheduled to retire at various times up to the year 2021. The major immediate impact of the new act is to allow SCRA to issue bonds only for the purpose of refunding SCRA bonds issued prior to December 31, 1992; it also reduces from \$200 million to \$60 million the total principal authorized amount of SCRA bonds outstanding at any one time. Sections of the act regarding the duties of WRCC and JEDA will not be repealed until all bonds issued by SCRA are retired.



# The Roles of JEDA and SCRA

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## Moral Obligation Bonds

The bond rating company rated the SCRA bonds as “moral obligation” bonds. This means that, if there is a shortfall in local revenues, the General Assembly may appropriate funds to pay any shortfall in principal and interest due bondholders. In such a case funds would be deposited to SCRA’s capital reserve fund, from which principal and interest on bonds would be paid.

A June 14, 1994, attorney general’s opinion, while noting that bond law is very specialized and that a bond attorney could interpret this area differently, indicates that the state appears to have the power, but not the duty, to incur indebtedness on behalf of these revenue-producing bonds. The opinion states that, “Whether the General Assembly would determine to pay off the bond would apparently be something that would have to be decided by the General Assembly on a case-by-case basis.”

The state’s credit rating can be negatively affected if bonds default. The state has intervened in three cases. The town of New Ellenton has defaulted its bond; and according to an official with the state treasurer’s office, the state has set aside up to \$425,000 to help the town make debt payments (see p. 22). In addition, state funds have been used in order to prevent default on the bonds of Ridgeland and Turbeville. From FY 92-93 through FY 94-95, the amount of state funds committed to the three towns totals more than \$1.2 million.

Because state funds can be used to cushion local revenue shortfalls, state oversight of the local bond debt is important. This is accomplished primarily through two means: performing an adequate “creditworthiness” analysis to ensure that the local borrower has the ability to pay the bond debt; and ongoing monitoring to ensure that rates are high enough to generate the revenues needed, that the covenants of the bond ordinance are followed, and that bond proceeds are used appropriately. This chapter reviews how credit analysis and monitoring of bond debt were performed.

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## Credit Analysis

JEDA's overall credit analysis was weak. According to §11-37-200 of the South Carolina Resources Authority Act, JEDA is to "... provide the staff to receive, research, investigate, and process applications for projects made to the coordinating council (WRCC) and assist in the formulating of priorities." JEDA focused its efforts on determining the creditworthiness of the applicants. Creditworthiness is only one of the eight criteria established in §11-37-200(B)(2) of the South Carolina Code of Laws (see p. 25) that must be considered by WRCC in its review of applicants to the program.

We reviewed JEDA's files for six borrowers in the 1990 and 1991 bond issues including: the town of Estill; the Georgetown County Water and Sewer District; the city of Isle of Palms; the town of Mt. Pleasant; the city of New Ellenton; and the town of Williston. These borrowers were selected judgmentally and comprised over one-half of the debt issued in the 1990 and 1991 bond pools to finance water and wastewater projects. In applying, they were required to submit revenue projections of operations and relevant demographic and other data concerning the projects. Our review of these files consisted mainly of reviewing JEDA's method of analyzing applications. We found deficiencies in the files in three categories as outlined below.

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We found no evidence that an independent analysis of revenue projections was completed by JEDA.

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- JEDA relied on projections of operations provided by program participants in evaluating the ability of participants to make future debt service payments. We found no evidence that an independent analysis of the revenue projections was completed by JEDA.

For example, the projected revenues from the town of New Ellenton sewer project were overstated. JEDA did not evaluate the projections and this led to debt repayment problems. Also problems have arisen with projections for the towns of Ridgeland and Turbeville (see p. 23). Additionally, other recipients are having trouble maintaining an adequate level of debt service coverage (see p. 10).

JEDA relied on the fact that the projections were to be prepared by a licensed professional engineer as the only assurance that project estimates and projections were reasonable and valid. However, in our review of the 19 files for participants of the 1990 and 1991 issues, we found that revenue projections for nine local governments were not adequately certified with a professional engineer's signature. Several of the files contained revenue schedules signed by the local government's administrator or manager.

Standard & Poor's (S&P) *Debt Ratings Criteria* points out that projected operations should be analyzed and should not be necessarily assumed to be accurate. Assumptions should be challenged, and the results evaluated before significant weight is attached to them.

We interviewed several officials involved with the South Carolina Water Quality Revolving Fund Authority at the Division of Local Government. This agency makes loans to local governments for wastewater projects and requires the signature of the project engineer who must certify that the project estimates and projections in the application are reasonable and valid. Also division staff prepare independent projections based on historical data which are then compared to those submitted by the applicant.

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JEDA did not properly evaluate the overall economic condition of the applicants.

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- JEDA did not properly evaluate the overall economic condition of the applicants. JEDA recommended that WRCC accept applicants based on the debt service coverage percentage. This was the primary focus of the creditworthiness review performed by JEDA. According to S&P, many areas should be considered when reviewing the financial viability of water and wastewater systems. These include such areas as legal provisions (especially the authority to raise rates), economic environment, and operations and finance.

For example, JEDA did not review the Isle of Palm's historical debt service coverage calculations for the three years prior to its application. The system had been recently purchased from a private utility company. Although historical annual reports containing financial as well as operating information were available at the South Carolina Public Service Commission, JEDA's program administrator did not obtain or review these records.

The magnitude of debt service coverage is not as important as the stability and predictability of such coverage. Quality of revenues, not quantity, is most important, according to S&P.

- JEDA's loan files lacked essential documentation. We reviewed 11 of the 19 loan files of participants in the 1990 and 1991 issues to determine if files contained essential documentation required by JEDA.

The following table shows the results of our examination regarding financial documentation which was required by the SCRA application. As shown, we did not always find information critical to the evaluation of applicants.

Table 2.1: Review of Selected Loan Files for Financial Documentation

Items in Application Package Relating Primarily to Creditworthiness Analysis	Aiken 1990	Dillon 1991	Edgefield 1990	Edisto 1990	Estill 1990	Georgetown 1990	Lexington 1990	New Ellenton 1990	Ridgeland 1991	Turbeville 1990	Williston 1991
Schedule D - Financial	✓	✓	✓	✓	✓	✓	✓	✓	✓	No	✓
Audited Financial Statements for Last 3 Years	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Current Interim Financial Statements	✓	✓	No	✓	✓	No	✓	✓	✓	No	✓
Operating Budget for the Current Fiscal Year	✓	✓	No	✓	✓	✓	✓	N/A**	✓	✓	✓
Detailed Projections, Prepared/Approved by Consulting Engineer	✓	No	No	✓	*	No	✓	✓	✓	✓	✓

\* Documentation for one year was inadequate.

\*\* No current operating budget available for sewer system since it was to be a new system.

Additionally, our review of selected files revealed deficiencies in methods used by JEDA to obtain information. For example, in processing two applications for approval by WRCC, JEDA's program administrator stated that it was likely he accepted financial information by telephone. We could not find written evidence of the information provided by telephone, and we could not document the validity or source of the data.

Also, in 20 of 34 cases, the recommendation for funding was contingent upon certain conditions being met by the applicant. Some applicant files maintained by JEDA did not document that contingencies had been met. In order to confirm resolution of contingencies, we had to secure documentation from a variety of state and local sources.

JEDA assigned only one employee to the SCRA program, and JEDA did not follow its own written lending policies. The employee did not have previous experience in the financing of water and wastewater projects nor with the oversight of public funds. According to this employee, upon employment with JEDA, he attended one training workshop which concerned the evaluation of local government financial statements. Although this employee had some previous lending experience, he may not have had the necessary training to perform adequate credit reviews of the participants in this program. In addition, we did not find evidence in the files that supervisory staff reviewed/approved his work.

The written procedure currently outlined in JEDA's lending policy, which would have involved several levels of professional employees to provide supervision, was not followed. These policies appear to be generic in nature and would be applicable to SCRA's program. For example, a step-by-step processing flow designates responsibilities, establishes a sequence of events and interaction between loan officers and senior staff, and lists required documentation. The senior loan officer is required to review and analyze a proposal prepared by the loan officer. After any recommendations or comments are resolved, a consensus must be obtained with the senior loan officer and either the chief operating officer or the chief executive officer before proceeding to the loan committee for approval.

Without a thorough review of the applicants, JEDA could not be assured of the financial viability and ultimate creditworthiness of the participants in the program. This program is supported by a moral obligation of the state (see p. 5) and relies on future revenues generated by the projects that are funded. Without a careful and complete evaluation of each participant, the state cannot be protected against the possibility of default of program participants.

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## Recommendations

- 1 JEDA should independently analyze the projections supplied by applicants to the program to ensure the adequacy of revenues to support debt service payments.
- 2 JEDA should consider a broad range of relevant issues when reviewing borrowers' creditworthiness and not rely on one calculation.
- 3 JEDA should fully document that applicants have met all application requirements.
- 4 JEDA should assign staff to functions based on their training and expertise. Staff should adhere to written lending policy and receive adequate supervision from agency officials.

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## Status of Debt Obligations

In order to calculate debt service coverage requirements as mandated by local bond ordinances, we performed a desk review for fiscal years ending 1992 and 1993 of all participants with outstanding debt held by SCRA. Mt. Pleasant and Pageland have defeased (set up irrevocable trusts for) outstanding debts. Our review was limited to audited financial statements issued by these borrowers. While this was not an in-depth review, it can serve to identify potential debt repayment problems. We found eight borrowers that did not have adequate debt service coverage requirements and may need to raise rates. These borrowers should be closely monitored by SCRA to avoid future difficulties in funding debt service.

### Debt Service Coverage Requirements

Local bond ordinances, which are generally standard, state that rates and charges shall be sufficient to:

- Pay all expenses of operating and maintaining the system.
- Build up all required reserves.
- Provide at least 120% of the annual principal and interest requirements of the bond held by SCRA and any further obligations which are encumbrances upon the revenues of the system.

We found eight borrowers that were not in compliance with the provisions . . . concerning debt service coverage for either one or both years ending 1992 and 1993.

In most cases, ordinances require the local governments to review revenues quarterly and to raise rates to correct any shortfalls. In addition, the local bond ordinances generally require that a yearly audit be performed by an independent certified public accountant. Through amendments to the bond ordinances, SCRA could reasonably require that annual audits report, in the notes to the financial statements, compliance and/or non-compliance with the bond covenant regarding rates and charges. Monitoring efforts would be facilitated, and a review such as the one we performed would essentially be unnecessary.



We calculated the debt service coverage percentage as follows:

Debt	Gross Revenues – (Operating Expenses – Depreciation) – Other Debt
Service =	+
Coverage	SCRA Annual Debt Service Payment

The result of this calculation should be equal to or higher than 120% in order to comply with the requirements of the rate covenant outlined above and ensure funds adequate to repay the debt. When funds are not adequate, the local government is faced with either using funds from other sources or entering default status. Using funds that are not system revenues is a violation of the local bond ordinance.

### Results of Our Review

We found eight borrowers that were not in compliance with the provisions of the local bond ordinance concerning debt service coverage for either one or both years ending 1992 and 1993. This means their debt service coverage was below 120%. Our review found that most of these borrowers had debt service coverage below 100%. In 1992, the B&CB directed the Division of Local Government to review SCRA's portfolio. Although no official report of their review was issued, we obtained brief summaries in order to compare our results. Our findings agreed substantially with the findings of local government's review. Table 2.2 displays the results of the LAC review based on 1992 and 1993 information.

For 1993, three of the eight, Turbeville, Varnville, and Williston, had come into compliance. This may be partly attributable to recent reviews.

The division's review sometimes commented on the general financial health of the borrowers reviewed. They found cases where the local government:

- Was meeting requirements, but had negative financial trends.
- Needed to increase funding of depreciation and contingency reserves.
- Was financially strong but needed a rate increase to be in compliance.

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**Table 2.2: Borrowers Not in Compliance With Debt Service Coverage**

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Are local borrowers in compliance with debt service coverage of 120%?			
Town	Year of Bond	1992	1993
Estill	1990	yes	no
Lexington County	1990	no	no
New Ellenton	1990	no	no
Santee	1989 and 1990	no	not reviewed
Turbeville	1990	no	yes
Varnville	1989	no	yes
Williamston	1989	no	no
Williston	1989	no	yes

All eight borrowers will require special oversight to avoid future difficulties in paying debt service on the outstanding bonds held by SCRA. Since debt service coverage can fluctuate from year to year because of changes in operations, ongoing review of trends can identify potential shortfalls and help resolve problems before revenues erode further (see p. 13). Adequate monitoring and oversight would include a review, over time, of the local government's overall financial condition including downturns in operating results.

#### **Limitations of Our Review**

Our analysis was limited since we obtained figures from audited financial statements without the benefit of interviews with relevant personnel or other methods to expand our information. Our review occasionally included the use of estimates based on available information. In addition, we could not determine from the financial statements the amount of funds paid into reserve accounts. The required level of payment for reserve funding is not defined in the local ordinances. Reserve accounts are required in order to fund unforeseen contingencies and replacement of plant and equipment. By not

including any provision for reserves, our calculation of debt service coverage would be overstated and, therefore, probably overly optimistic.

The towns of Branchville and Santee were reviewed for 1992 but were excluded from our review for 1993 because their audit reports had not been issued as of June 29, 1994.

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## Recommendations

- 5 The Budget and Control Board should continue to monitor the debt service coverage for all SCRA bond participants.
- 6 Bonds which are supported by state guarantees should contain language in the bond ordinance that requires CPAs performing yearly audits to report, in the notes to the financial statements, compliance and/or non-compliance with the bond covenant regarding rates and charges.
- 7 For its outstanding bonds, SCRA should consider requesting that borrowers amend local bond ordinances, within the legal parameters already existing, to provide that CPAs performing yearly audits report, in the notes to the financial statements, compliance and/or non-compliance with the bond covenant regarding rates and charges.

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## Monitoring of Construction and Debt

The SCRA act does not require that local governments be monitored to ensure they are financially capable of meeting their debt obligations and are using bond proceeds appropriately. Without such monitoring, it is difficult for the state to intervene in a timely manner when a default is likely. If a local government has problems repaying its debt, this could impact the state negatively since the state may appropriate funds to help local governments meet their debts in order to protect the state's credit rating.

Local bond ordinances uniformly require local governments to comply with certain requirements. As sole bond holder, SCRA has the ability to enforce compliance with bond requirements. In addition, the state has the authority to withhold state funds and/or require the local government to levy an ad valorem tax in order to make up any shortfall in debt payments.

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SCRA's enabling legislation  
... does not expressly  
require that SCRA monitor  
... local governments ...

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SCRA's enabling legislation, however, does not expressly require that SCRA monitor the financial viability of local governments or ensure that the debt service ratio is maintained. JEDA's role is to research and process applications for the bonds. SCRA's by-laws limit the state treasurer to providing "... the staff services required in connection with the management, monitoring and administration of the Authority's debt obligations."

According to an official with the state treasurer's office, their monitoring consists of receiving notification from the trustee if the monthly debt payment is not made, and does not involve reviewing the local governments to determine if they are financially able to pay the debt service due to SCRA.

Additionally, the law does not address oversight of the use of bond proceeds during construction, even though 18 of the 19 projects funded in 1990 and 1991 were for the construction of new or expanded water and sewer facilities. Inappropriate use of bond proceeds could affect the viability of the systems and their ability to generate adequate revenues.

Other similar public programs monitor their debt. The FmHA, for example, approves monthly payment estimates and makes periodic on-site visits during construction to ensure the project is proceeding as planned. The FmHA also requires an annual budget and yearly audit reports. The federal funding program under the Economic Development Administration (EDA) of the United States Department of Commerce and the Division of Local Government under the South Carolina Water Quality Revolving Fund both perform similar monitoring of their projects.

Since 1992, the Division of Local Government has been directed to review SCRA's portfolio on a yearly basis. However, the B&CB has not formally established this as an ongoing program.

According to both state and federal officials, increased monitoring could raise the cost of the program. However, without monitoring the risk of default increases.

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## Recommendation

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- 8 The General Assembly may wish to consider requiring a formal system of monitoring the debt obligations of local governments which receive funding through SCRA. Areas to be addressed include: monitoring during the construction of projects; monitoring after projects are completed to ensure the continued ability of local governments to meet their debt payments; and how the costs of monitoring will be paid.
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## State Funds Used To Pay Local Debt

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Three towns—New Ellenton, Ridgeland and Turbeville—have not been able to generate enough revenue to pay for their water and sewer bonds. In order to avoid default, the state has committed more than \$1.2 million to help the towns pay their SCRA debt through FY 94-95.

Serious issues surround New Ellenton including the lack of controls over bond funds, a plant built on private property and failure to hold a voter referendum, as well as fraud and embezzlement. The lack of adequate revenues may indicate that the system will not be self-supporting in the near future.

The problems in Ridgeland and Turbeville are unlike those of New Ellenton. These towns expanded water and sewer systems to meet the demand of two state prisons being built. The opening of these prisons has been delayed by the state, and the towns have not had sufficient revenues to pay debt service to SCRA. The following section details the problems facing the three towns.

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### New Ellenton

In March 1990, the town of New Ellenton applied to SCRA for financing for a new sewer system. SCRA authorized a bond in the amount of \$5,025,000; approximately \$4 million for the estimated cost of the sewer system and \$1.025 million for fees and the required capitalized interest and debt service reserve funds.

New Ellenton's debt service payments, starting in June 1992, were \$35,220 monthly to NationsBank, which is the bond trustee. Almost immediately the town began faltering in its payments, and by June 1993 was in default. In February 1994, the former mayor of New Ellenton was charged in state and federal court with fraud and embezzlement involving the bond funds.

Several agencies became involved with investigating the situation at New Ellenton, including:

- The Division of Local Government of the Budget and Control Board.
- The state auditor's office.
- The state engineer's office.
- JEDA.
- The State Law Enforcement Division (SLED).
- The Federal Bureau of Investigation (FBI).

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... all but \$164,000 was spent by 1993. The sewer system is only 82% complete.

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We reviewed reports and some documentation collected by those agencies that have completed their reviews, and we have conducted our own research as well. We have summarized all relevant findings and conclusions below.

#### **Revenues and User Projections Overstated**

Of the \$4.2 million issued for construction of the project, all but \$164,000 was spent by 1993. The sewer system is only 82% complete. The sewer system has never been self-supporting, contrary to the revenue projections developed by the project engineer. (The project engineer, through his involvement in the development firm which owns the land for the wastewater treatment site, had a vested interest in seeing that the sewer system was built (see p. 17).

For example, the engineering pro forma, submitted to JEDA as part of the bond application, assumes monthly revenues from sewer user charges of \$47,116 for FY 92-93. The actual monthly revenues from user fees for that year averaged \$7,069. New Ellenton was forced in 1993 to support the system with its general operating funds, which caused financial hardship for the town. A financial audit found that the town's sewer department ran an operating loss of \$260,804 in FY 92-93.

By June 1994, only 231 customers were actively using the system, instead of the 1,085+ users initially shown in the engineering report. Another 181 customers were not hooked up to the system but are paying a mandatory \$25 a month sewer fee. Gross revenues from the sewer system this year have been around \$11,000 to \$12,000 a month, not enough to pay the current monthly debt service of \$34,939 plus the costs of operation, maintenance and reserves.



JEDA did not perform any independent analysis of revenue projections provided by applicants. JEDA should have questioned the 1,085 users initially projected; some lived outside town limits along Highway 19 corridor and could not legally be mandated to hook up to the system. The engineer estimated construction costs to be \$4 million including this corridor. Eliminating this section from the project left about 890 potential users within the town limits.

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According to a consulting engineer, even if all potential users are hooked up, the system as currently constructed can serve only approximately 648 users.

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Also counted in the projections were another 181 users who lived in a low-to moderate-income area. Some of these homes did not even have indoor plumbing. Bond funds were not to be used for sewer lines to this area. Instead, the town planned to apply for a grant for this part of the town. However, as of June 1994, the town had not finished its application for this grant.

Currently, the sewer connection lines do not extend to every house, or even to every neighborhood in New Ellenton. According to a consulting engineer, even if all potential users are hooked up, the system as currently constructed can serve only approximately 648 users. At the current fee structure, this number of users cannot generate adequate revenues to cover the debt service. Because construction funds are depleted, there is no money to extend the sewer collection lines. Yet without more users hooked up to the system, it will never generate the revenues needed to be self-supporting.

#### **Waste Treatment Plant on Private Land**

The project engineer for the sewer system is involved in the development firm which owns the land for the treatment plant and spray field. The treatment plant and spray field are built on 165 acres of land leased to the town by the Banks Mill Partnership, a real estate development firm, under a five-year lease which began July 2, 1990.

This land is part of a large tract bordering New Ellenton, where the partnership also was planning a residential and golf course development known as Cedar Creek Properties, Inc. The Banks Mill partnership, doing business as Cedar Creek Utility, holds the DHEC discharge permit for the wastewater treatment plant and spray field.

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The project engineer for the sewer system is involved in the development firm which owns the land for the treatment plant and spray field.

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The project engineer for the sewer system was the president of Cedar Creek Properties and a managing partner in Banks Mill. In addition to developing the original revenue projections for the sewer system, he performed

contracting, designing, inspecting and engineering work for the sewer project.

Prior to 1990, Aiken County had planned to use Cedar Creek Utility's DHEC permit and to construct a sewer system for New Ellenton as part of a planned, county-wide wastewater treatment system. The treatment plant was to be an "interim" plant, until such time that New Ellenton could be part of a county-wide sewer system. However, Aiken County could only obtain financing and operate the sewer system contingent upon a positive voter referendum. This referendum failed, and New Ellenton assumed sole responsibility for its portion of the sewer project.

New Ellenton then negotiated two separate contracts with Cedar Creek/Banks Mill in 1990—one for the construction of the sewer system and one for leasing the land for the treatment plant and spray field. The land lease runs for only 5 years, even though the town's sewer bond debt is payable over 30 years.

New Ellenton took over the operation of the wastewater treatment site in March 1992. Banks Mill currently leases the 165 acres of land for the sewer plant and spray field to New Ellenton for \$10 a year, plus property tax on the land. According to New Ellenton officials, this amounts to about \$8,000 annually. When the five-year lease is up, New Ellenton has the option of buying the land, at \$3,000 an acre with an increase of 7% every year after July 1990. Based on these conditions, the 1995 selling price of the land will be \$694,263.

The land application permit issued by DHEC, which is needed to operate the sewer system, is still held by Cedar Creek Utility, and is not in New Ellenton's name.

According to disbursement records provided by local officials and reviewed by the state auditor's office, \$903,146 from the bond proceeds was paid to Cedar Creek Properties, mostly for land clearing, treatment plant construction and a water system. Another \$328,000 from the bond proceeds was disbursed to the project engineer directly for engineering and design work.

### **JEDA's Application Review**

We found no evidence that the information presented to WRCC mentioned that the treatment site was to be on private land. Nor did WRCC seem to be aware of the relationship of the project engineer with Cedar Creek/Banks Mill.

JEDA had this information but did not act on it or report to WRCC. For example, the engineer is identified in JEDA's files in the application package on revenue projections and in several pieces of correspondence. The resolution passed by the New Ellenton City Council clearly states the treatment plant and spray field would be built on land owned by Cedar Creek Properties, Inc. The engineer signed the contract between Cedar Creek Utility and the town dated April 16, 1990. Finally, a letter to JEDA dated March 8, 1990 states "Cedar Creek Properties, Inc., is represented by . . . [the engineer], who are also New Ellenton's consulting engineers for the . . . project."

We found no evidence that JEDA or WRCC ever questioned the number of sewer system users projected in the preliminary engineering report, although, as previously discussed, these figures were grossly overstated. In addition, both town and state officials based the capacity of the sewer system on anticipated population growth in the area. Their assumptions, however, depended upon the future expansion of the Savannah River Plant and the construction of a research park, which did not occur.

In the engineering report provided to JEDA as part of the application package, the project engineer also stated that the "developers of the Cedar Creek Golf Club have plans for approximately 700 residential units and an office/industrial park which would require sewer." However, in May 1989 the project engineer applied for septic tank permits for his Cedar Creek development, and after the bond was approved by WRCC in March 1990 he received the permits.

### **Use of Sewer Bond Funds for Other Purchases**

Although the town spent \$4,086,517 in bond construction revenues, a cost estimate performed by a consulting engineer found the present value of the sewer system to be \$2,642,198. This does not include about \$400,000 paid for engineering, surveying, and attorney fees. Based on the analyses performed by SLED, the state auditor's office and the consulting engineer,

we found that at least \$940,000 in bond revenues were diverted for uses other than the sewer system.

New Ellenton's former mayor approved the use of approximately \$364,000 from the bond proceeds to purchase a water system from Cedar Creek Properties. The water system was purchased to provide water for the treatment plant and spray field. It had been installed by Cedar Creek Properties originally for use in the subdivision. According to the state engineer, the town could have installed a well to provide water to the sewer system at a much cheaper cost.

A consulting engineer's report also found that sewer bond revenues were used to build an airfield on the Banks Mill property at an estimated cost of \$225,300. Several buildings and sheds built on the wastewater treatment site cost an additional \$63,800. SLED documented the use of \$18,881 to buy a Piper Cherokee airplane which was titled to the former mayor. About \$40,000 in bond funds were used to re-pave a road in the Cedar Creek subdivision when it was damaged by a break in the water line.

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. . . we found that at least \$940,000 in bond revenues were diverted for uses other than the sewer system.

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#### **Former Mayor Indicted for Fraud, Embezzlement**

According to federal and state indictments, other funds are alleged to have been diverted by the former mayor of New Ellenton. The state indictment charges that he fraudulently submitted at least 25 requisitions to the bond trustee, with a total value of at least \$246,715. These funds were then deposited in bank accounts under the mayor's control and allegedly were used for the mayor's personal benefit. Some of these fraudulent requisitions allegedly were from fictitious companies controlled by the mayor. Other requisitions allegedly padded the amounts actually due to various subcontractors. The mayor also is accused of forging endorsements on checks written to various vendors and contractors who were being paid from sewer bond funds.

According to the state indictments, the former mayor also engaged in a "continuous pattern of misconduct and negligence with respect to the administration of his office . . . (which) seriously impaired the construction of the Town's Sewer Project . . . ."

The federal indictment charges that the former mayor used the United States Postal Service and bank wires affecting interstate commerce to bring about these frauds.

As of June 1994, the SLED and FBI investigations were still ongoing.

### **No Controls Over Disbursement of Funds**

With no system of oversight and accountability for the bond construction funds, potential for fraud and abuse increased.

According to a financial audit of New Ellenton, the town had not established separate records for the sewer bond revenues, had not maintained a general ledger, and had co-mingled sewer bond funds with town funds. Therefore, the town did not have in one place a complete accounting for all the construction funds.

In addition, the bond proceeds and disbursements for construction were under the control of one individual. The bond ordinance required only a requisition certified by the mayor for the bond trustee to release the funds.

Good business practices were not followed in spending the bond proceeds. Most of the materials and services for the sewer were not bid out. Requisitions were not always documented by original invoices. There were no requirements that the project engineer inspect the work by subcontractors before the bank trustee released construction funds.

According to town officials, the town is not carrying any type of hazard insurance on the sewer system, contrary to the bond ordinance requirements. The financial audit also confirmed that in several instances the town is in non-compliance with applicable laws, regulations and bond ordinance requirements involving the sewer system.

In addition, easements for the sewer lines were not properly obtained from residents. According to town officials, only four easements are properly recorded. At least three or four property owners have sued for damages caused by a lack of proper easements. These cases have been settled with the state Insurance Reserve Fund.

### **The Referendum Issue**

The South Carolina Constitution, Article VIII, Section 16, requires a majority vote of electors for the initial acquisition of a sewer system by incorporated municipalities. A referendum is not required if a sewer system already exists. Therefore, the town was required to have either a referendum

or an existing system. The town's application to JEDA states that the bond was to be for a "new system—not part of a regional system"; that a current sewer system "does not exist," and that "the town of New Ellenton and surrounding areas have no sewerage system. Numerous septic tanks have the potential to damage groundwater supplies."

Yet the final bond ordinance states that there *is* an existing sewer system, and that the "system is operated by and is under the full control and management of the Town Council and furnishes sewer services throughout certain areas of the Town." According to New Ellenton town officials, this "existing sewer system" was no more than a 1,000 gallon septic tank shared by the old jail, civic center and former town hall.

In correspondence maintained at JEDA's office, the local bond counsel stated that he determined a referendum was not needed based on the Revenue Bond Act for Utilities. This act (§6-21-530) authorizes municipalities to issue bonds without first submitting them to voter approval. However, based on legal research we have concluded that the voting requirements of Article VIII, Section 16, apply regardless of the source of funding.

Since New Ellenton never held a referendum, citizens had no chance to vote on a sewer system that would directly affect them with a mandatory hook up requirement and user fees. According to a 1993 utility rate survey, New Ellenton's sewer rate is \$25 for the first 3,750 gallons, which is the third highest in the state.

Also, without a referendum there was no clear indication that New Ellenton citizens supported the sewer project. Some New Ellenton citizens objected to the way the sewer system was being planned and financed. Objections were made by group of citizens to the Governor's office prior to the issuance of the bond.

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## Conclusion

The town of New Ellenton is currently under a consent order with the bond trustee, NationsBank, to deposit all sewer revenues with the trustee. From these revenues, the town is allowed some funds for the operation and maintenance of the sewer system. In spite of this, the town still had a shortfall of \$131,000 for the June 1994 debt service. The state has set aside \$425,000 to use for debt service shortfalls.



A review of this information shows that there was no single cause of New Ellenton's sewer problems, but that many factors were involved. These include:

- The overstating of the revenue projections and number of expected users of the sewer system.
- The project engineer who prepared the projections stood to gain from the construction of the treatment plant on Banks Mill land.
- The assumptions that the Savannah River Plant expansion would create increased demand.
- The failure by JEDA to verify the projections and information contained in the loan application.
- The failure to hold a voter referendum.
- The apparent lack of local support.
- The failure of the town to obtain proper easements.
- The inability of the town to maintain the proper accounting records and controls over funds.
- The alleged criminal actions of the town mayor.
- Finally, the fact that no state-level entity had clear authority to monitor the project once funding was approved.

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## Ridgeland and Turbeville

The towns of Ridgeland and Turbeville have received state-appropriated funds, as well as funds from capital improvement bonds, to help make debt service payments on their SCRA bonds. These funds totaled \$802,077 over two years. Although these funds have been termed "impact fees" in actuality they were needed to help prevent default by the towns on their bonds.

Ridgeland and Turbeville originally obtained SCRA funding in order to expand their water and sewer systems to meet the demand of two new state

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. . . the towns have not had sufficient revenues to pay debt service to SCRA.

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prisons. In 1990, Turbeville signed an agreement with the Department of Corrections to provide services to the newly constructed prison. In 1991 Ridgeland signed a similar agreement. However, the prisons in both towns have not been opened. As a result, the towns have not had sufficient revenues to pay debt service to SCRA.

In January 1993, the Department of Corrections paid \$250,000 to Turbeville and \$220,000 to Ridgeland. These payments were made according to amendments to the original agreements with DOC and were termed "nonrecurring impact fees." Impact fees usually are designed to ensure that adequate services will be available for new development. However, documentation shows that the fee paid to Ridgeland was based on what the town needed to make its debt service payments.

These fees were charged to the capital improvement bond funds used to construct the prisons, and were deemed appropriate by legal counsel as long as they would ". . . be chargeable to the capital account of the facility." Following this opinion, the Office of the State Auditor confirmed that the impact fees would be considered a part of the cost of the capital improvement project and subject to capitalization.

The prisons did not open the following year as well. As a result, the towns again did not have sufficient revenues to pay their debt obligations. In June 1994, the DOC paid \$87,625 to Turbeville and \$244,452 to Ridgeland as impact fees for the availability of services. The Turbeville payment was from state-appropriated funds and was based on the minimum monthly usage projected for the prison.

Of the amount paid to Ridgeland, \$102,694 was from capital improvement bond funds and \$141,758 was from a state appropriation specifically planned for this payment. Unlike Turbeville, the payment to Ridgeland was not based on the minimum monthly usage requirement. Rather, it was based on what the town needed to make debt service and pay the operating and depreciation costs of the expanded system, and was \$36,334 higher than the amount based solely on the minimum usage requirement.

According to DOC officials, no opinion was obtained from an attorney or from the state auditor regarding the second payment of impact fees. We found no evidence that the agreement between the towns and the DOC was amended further to allow the second impact fee. According to a DOC official, the Turbeville prison is expected to open in January 1995. However, it is anticipated that the Ridgeland prison will not open until January 1996. Therefore, it is likely the state will have to assist Ridgeland in making debt payments in 1995.

# The Role of WRCC

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## Project Criteria

Specifically, pursuant to §11-37-200(B)(2) of the South Carolina Code of Laws, WRCC must consider at the minimum the following eight criteria in selecting projects.

- (a) **Regional development**—the need for multi-jurisdictional projects and the cooperation and coordination for regional economic development projects.
- (b) **Development potential**—the degree to which economic development activity can be stimulated in any given area and infrastructure used as a proactive economic development tool.
- (c) **Economic impact**—the degree to which jobs and income can be generated if the infrastructure improvements were made.
- (d) **Local commitment and initiative**—the availability of the local 50% match and local recognition of complimentary infrastructure needs including, but not limited to, such needs as transportation.
- (e) **Infrastructure need**—the degree to which specific infrastructure problems can be addressed and solved.
- (f) **Area economic need**—the degree of local “distress” and need for economic assistance, particularly less developed or rural areas of the state.
- (g) **Creditworthiness**—the financial soundness of the infrastructure project, including the availability or lack of other funds to finance the infrastructure project.
- (h) **Public health and welfare**—to meet public health and welfare requirements within the local area.

We used these criteria in our evaluation of the effectiveness of the SCRA infrastructure funding program.

This chapter reviews the performance of WRCC in using these criteria to establish funding priorities. We also reviewed how WRCC evaluated applicants for funding, coordinated with other sources of infrastructure funding and administered the program.

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## Funding Guidelines

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Although the program had a \$200 million cap, information available showed the state's water/sewer infrastructure needs will amount to over \$1 billion by the year 2000.

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WRCC did not fund applicants on the basis of the criteria set out in SCRA's legislation. Section 11-37-200 of the South Carolina Code of Laws requires WRCC to promulgate regulations establishing these criteria for funding priorities; WRCC did not do so. No guidance was developed as to how much weight should be placed on each criterion.

The legislative intent of the program, as stated in §1 of Act No. 682 of 1988, was to promote the general health and welfare of all South Carolinians and to act as an incentive to foster economic growth, particularly in the rural, less-developed areas of the state. Although the program had a \$200 million cap, information available showed the state's water/sewer infrastructure needs will amount to over \$1 billion by the year 2000. WRCC approved all applicants JEDA brought before them for consideration.

JEDA, in its role as staff for WRCC, presented a package of procedures and documentation for the infrastructure program at WRCC's initial meeting held on January 10, 1989. This package included three sections:

- Operating Guidelines for Receipt, Rating and Ranking of Applications.
- Application Package.
- Outline of Marketing Strategy.

The Operating Guidelines for Receipt, Rating and Ranking presented by JEDA was a point system devised to systematically quantify the eight criteria. Such a system could have been useful in evaluating which projects should be funded.

However, we were not able to determine from meeting minutes if the ranking procedure or the marketing strategy were ever formally approved for use by WRCC. Our review of applicant files and information presented to WRCC determined that only the application package was used. Implementation of the other sections, the ranking and marketing procedures, was not documented in the files.

We attempted to determine how the localities funded through SCRA would have scored under the guidelines for three of the more clearly defined criteria. We found that a significant percentage of applicants would not have scored well under the guidelines. For example, under area economic need, projects located in less-developed counties were to receive more points than

more developed counties. Of the 19 projects funded by SCRA in 1990 and 1991, approximately one-third were in developed counties and would not have received any points under the proposed rating and ranking system. Only 42% of the 19 projects were located in less developed counties.

In addition, localities designated by DHEC as imminent health threat areas or under a DHEC-mandated tap moratorium (meaning the existing system would not support new, non-residential customers) were to be given a higher priority for funding. Our review of the 19 proposed projects found that none were designated imminent health threat areas. Only 2 (11%) of the 19 applicants were under a tap moratorium at the time of their applications for SCRA funding. Also, projects which had multiple sources of funding were to receive a high ranking. Based on the criteria set forth in the proposed guidelines, eight had multiple sources of funding.

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## Recommendation

- 9 WRCC should promulgate regulations establishing criteria for funding priorities as required by §11-37-200 of the South Carolina Code of Laws.

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## Freedom of Information Act

Although we did not examine all aspects of compliance with the Freedom of Information Act (FOIA), we noted instances where WRCC took action by telephone poll rather than in a public meeting. This is a violation of the FOIA.

According to opinions issued by the attorney general, both general law and the FOIA require that a public body meet collectively in a formally convened meeting in order to take official action upon matters over which it has authority. As stated in a 1984 attorney general's opinion, the purpose of the rule is to afford each member of the body an opportunity to be present and to impart to his associates the benefit of his experience. A telephone poll is not considered a meeting for these purposes; however, a telephone conference call would have been appropriate as long as all other requirements, such as proper notice, were met.

WRCC members individually approved applicants or increased funding through telephone polls conducted by JEDA. For example, a memorandum

to WRCC members from JEDA dated March 27, 1989, states that the members of WRCC were polled by telephone and approved the town of Williston's request for funding. In addition, at its meeting held March 26, 1990, WRCC tabled a request for funding from the town of Santee, agreeing to reconsider the request by telephone after several conditions were met. A letter to SCRA from JEDA several months later states that approval was granted by telephone poll. This same letter states that telephone polls of WRCC members were conducted for purposes of increasing previously approved funding levels. We could not document the consistency of the information included in the telephone polls because notes pertaining to these calls were purged from JEDA's loan files.

Compliance with the FOIA helps ensure that citizens have access to information on the manner in which elected or appointed officials conduct public business.

Willful violation of the FOIA can result in criminal charges.

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## Recommendation

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10 WRCC should comply with the requirements of the Freedom of Information Act governing public meetings.

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## Technical Assistance

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WRCC did not create an approval process that fully integrated and utilized the collective knowledge of the member agencies. Consequently, WRCC did not have adequate information about all relevant issues. Although member agencies have staff with expertise in water planning, economic development, and health areas, WRCC's decisions on whether to fund projects were based largely on JEDA's creditworthiness review.

WRCC relied on information contained in a summary sheet prepared by JEDA staff which consisted of limited financial information relevant to creditworthiness of the applicant. There is no evidence the remaining seven criteria set out in the law were fully addressed.

For assistance in screening applicants, JEDA routed applicant information only to DHEC, the Water Resources Commission (WRC) and the Division of Local Government. According to the records, DHEC and WRC appeared

only to check for necessary permits. We found no evidence that these agencies were reviewing the applications to determine the existence of health hazards, the need for a regional system, etc. The Division of Local Government verified whether applicants were also receiving funds from its South Carolina Water Quality Revolving Fund Authority.

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Under the act, JEDA staff alone were not expected to become sole providers of technical information, some of which is outside their expertise.

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Technical information relative to economic development, health issues and water planning was necessary to help the program focus on statutory goals. The law required members of WRCC to provide technical assistance from their respective agencies for purposes of screening funding applications. Further, a review of the proposed ranking procedure discussed on page 26 revealed that input from the various agencies represented on WRCC would have been necessary in order for the ranking process to be accomplished.

While determining creditworthiness is within the scope of activities to be performed by JEDA, it was only one of the eight criteria to be considered by WRCC when establishing funding priorities. Under the act, JEDA staff alone were not expected to become sole providers of technical information, some of which is outside their expertise.

Currently, a Geographic Information System (GIS) initiated by the Department of Commerce (formerly the Development Board) could be useful in evaluating applicants. Information from this system, which can be displayed as maps or statistical reports, is designed to analyze the economic impact of water supply and wastewater systems and to encourage proactive economic development planning.

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## Recommendations

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- 11 Member agencies of the Water Resources Coordinating Council should establish an application review system that incorporates their staffs' specific expertise and provides for their taking an active role in ensuring that participating projects meet the criteria of the program as specified in §11-37-200 of the South Carolina Code of Laws.
  - 12 Data systems such as the Geographic Information System (GIS) should be used to the extent possible in evaluating applicants.

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## Applicant Summary

The 1989 applicant summary used to provide information to WRCC was inadequate for later bond issues. We were informed by the JEDA program administrator that the format of this summary was expanded for the 1990 and 1991 bond issues because the initial format used for the 1989 issue did not supply enough information to WRCC. However, we found five (42%) participants in the 1990 issue where JEDA presented applicant information to WRCC using the 1989 form.

The form may have been adequate for participants in the 1989 issue, since it involved refinancing outstanding FmHA debt. However, the initial form provided insufficient information to WRCC when used for borrowers participating in the 1990 bond issue. The participants in the 1990 and 1991 issues were financing the construction and upgrading of infrastructure facilities. Therefore, information relative to future revenues from the facilities as well as the general financial condition of the applicants was critical to the approval process. Regarding creditworthiness, the initial form contained only information on outstanding debt and three years of sales history. These data alone would not provide WRCC an adequate means of assessing the financial condition of the borrowers.

Lack of useful information could have hindered WRCC's ability to properly evaluate program applicants. By law, JEDA's duties included researching and investigating the applicants. Without the appropriate presentation of the research and investigation, WRCC could not be assured that such activity was carried out effectively.

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## Recommendation

- 13 JEDA should provide WRCC with adequate information regarding the creditworthiness analysis of applicants.



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## Marketing Efforts

For the 1990 and 1991 issues, JEDA did not direct its marketing efforts at infrastructure projects the program was intended to serve. This resulted in an approach that focused on processing applicants regardless of their qualifications to be served by the program (see p. 26).

At the initial meeting of the WRCC, JEDA presented an *Outline of Marketing Strategy*. This brief outline consisted of six items including the use of a preliminary needs survey of local governmental units. JEDA officials stated that in order to gauge demand, the needs survey was sent to over 500 local government leaders across the state during 1989. JEDA did not maintain adequate information on the survey responses, and we could not confirm any relationship between the responses available for review at JEDA and the applicants or what, if any, follow-up was performed.

According to JEDA staff, the marketing efforts for the 1990 and 1991 issues consisted of visits to local governments that were referred to JEDA as well as presentations to groups.

JEDA's marketing efforts may have been hindered because the appropriate target borrowers were not identified by WRCC. WRCC could have used the resources of its member agencies to develop a list of potential participants meeting the criteria of the program in order to provide the focus for JEDA's marketing efforts, but it did not. JEDA's efforts did not concentrate on target segments of the state.

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## Recommendation

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- 14 WRCC should identify target segments of the state that meet the criteria of the program in order to facilitate the marketing of the program. A list of potential participants should be developed jointly by all WRCC members.

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## Coordination of Funding

The WRCC established no formal procedures for coordination of funding. Some applicants were approved or received funding which could have obtained funding elsewhere. In addition, some applicants may have been able to obtain funding from lending programs that had lower borrowing costs.

Some borrowers used funds from several sources to fund their projects. A coordinated funding approach, which maximizes economy in borrowing, is desirable when serving program applicants who may have limited financial resources. While debt costs are borne by the rate payer, the bonds have a moral obligation feature which means the state may repay local debt in cases where locals are in default status (see p. 5). We identified nine sources of funding other than private credit markets.

Section 11-37-200(B)(2) states WRCC must, as a part of creditworthiness review, consider the availability of or lack of other funds to finance the infrastructure project. At the initial meeting of the WRCC on January 10, 1989, the chairman stated, "... the second function of this Council is to coordinate the various sources of infrastructure funding." At a WRCC task force meeting held on May 2, 1991, the chairman stated, "... the (WRCC) has a responsibility for the strategic element of consolidating and coordinating the various sources of funding available to water and sewer systems in the state."

The chairman of WRCC instructed staff to require that applications for SCRA funding be accompanied by applications for other grants or funding. Subsequently, JEDA requested copies of funding applications from several state agencies. However, according to a JEDA official, these were not provided.

Section 11-37-180 of the South Carolina code requires local governments to demonstrate to the satisfaction of SCRA that traditional financing sources are not available for the entire project.

The law allows local governments to satisfy this requirement by producing two letters of declination from financial institutions. JEDA did not attempt to further determine if any other sources of funding were available. However, this control was not effective. Our review of applicants approved for funding by WRCC identified two that subsequently withdrew because they were able to obtain private funding. In addition, we found one local

government that received SCRA funding which could have obtained private financing.

Each local government's bond ordinance obligated them to raise rates to their customers when necessary to repay the debt costs. Some other programs had funds available at lower borrowing costs and some offered grants. Combining funding options could result in lower borrowing costs and, therefore, lower water and sewer rates.

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## Recommendation

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- 15 The Water Resources Coordinating Council should establish formal procedures to ensure better coordination of sources of infrastructure funding.
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## Lien Position Policy

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A review of the 34 local bonds purchased by SCRA found 21 (62%) in which SCRA assumed a junior position relative to other outstanding debt. Approximately \$34 million (70%) of SCRA's over \$50 million in bonds is junior to other debt. A junior position makes it more difficult to collect funds in the event of a default because claims of senior debt holders would be paid first.

We identified 63 bonds which were senior to SCRA bonds. The original amount of outstanding bonds to which SCRA was junior ranged from approximately \$145,000 for one local government to over \$16 million for another. Of the 63 senior bonds, 38 (60%) were FmHA (Farmer's Home Administration) bonds. According to an official with the B&CB's Division of Local Government, FmHA debt is traditionally placed in a senior position. We also identified 25 bonds which were not FmHA and to which SCRA was junior. These included EDA and HUD (United States Department of Housing and Urban Development) bonds. Also, SCRA took junior positions to outstanding loans from the Budget and Control Board. Further, in two instances, SCRA debt was junior to previously issued SCRA debt.

Neither the statute nor SCRA by-laws contain a lien position policy. According to a JEDA official, neither WRCC nor JEDA had a written lien position policy. Local bond counsels were relied upon to determine the lien position of SCRA debt.

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Establishing a lien position policy may help the state ensure it obtains the most secure position possible in the event of a default by a local government.

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The South Carolina Water Quality Revolving Fund Authority administered by the B&CB's Division of Local Government adopted a lien position policy which "... requires the best lien position on the pledged revenue stream that is reasonably available from and affordable to the applicant." According to an official with the local government division, the authority has, in the past, obtained a parity position with a local government's outstanding Budget and Control Board debt. According to officials with JEDA and the Division of Local Government, in 1990 SCRA took a junior position at the request of a local government. In contrast, in 1991 the SRF declined to take a junior position when requested by the same local government.

Establishing a lien position policy may help the state ensure it obtains the most secure position possible in the event of a default by a local government. However, a strict policy requiring SCRA to be on parity with other debt could result in fewer borrowers qualifying for SCRA bonds. In addition, it could result in local governments being forced to raise user rates higher than otherwise would be required to obtain SCRA funding. Therefore, any policy developed should remain broad enough to accomplish the objective of reducing risk for the state while being reasonable and affordable for local borrowers.

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## Recommendation

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- 16 The General Assembly may wish to consider requiring the SCRA to establish a formal lien position policy which places the state in the most secure position possible while being reasonable and affordable for the local government.

# Infrastructure Facilities Authority Act Review

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On June 2, 1994, the General Assembly ratified the Infrastructure Facilities Authority Act (IFAA) §11-40-10 *et seq.* of the South Carolina Code of Laws. The bill was signed by the Governor on October 5, 1994. The IFAA creates an authority to replace SCRA (see p. 4). One major difference between the IFAA and SCRA is the IFAA does not issue bonds backed by a moral obligation of the state, according to bond counsel. Instead the act creates a revolving loan fund, to be capitalized from various sources, including state appropriations and federal funds. Loans, grants or bonds based on the fund are made available to communities for infrastructure projects. A second difference is that the IFAA broadens the types of projects which can be funded to include solid waste projects in addition to water and sewer projects. Also, the program would be administered by the local government division of the Budget and Control Board rather than the Jobs-Economic Development Authority.

We noted two principal areas of concern where the acts differ. These differences could have a negative effect on program outcomes.

## Priorities for Funding Not Identified

The SCRA was created, in part, to fund projects in rural, less-developed areas of the state. The act contains eight specific criteria which were to be considered when projects were funded. The Water Resources Coordinating Council (WRCC), composed of individuals with expertise and authority in areas such as economic development, health and water issues, was directed to set priorities based on the criteria set forth in the act.

The IFAA does not contain specific criteria setting forth how projects are to be prioritized. The act states that "all local governments are authorized to borrow money . . . [and] are also authorized to apply for, accept and receive grants . . ." (§11-40-80(A)). The Joint Bond Review Committee (JBRC) is directed to assist in establishing priorities for funding of the projects (§11-40-90(D)). However, it appears that the JBRC's involvement would be limited to entities funded through revenue bonds and would preclude their involvement with loans or grants.

### **Composition of the Authority**

Unlike the SCRA legislation in which members of WRCC participated because of their involvement with technical and financial aspects of infrastructure, this act does not appoint a panel of experts to evaluate projects. The Infrastructure Facilities Authority is composed of the members of the Budget and Control Board. This membership could be expanded to include a panel of experts; at the minimum, such a group could be advisory to the IFAA. While the staff of the local government division have various experience and backgrounds in similar financing issues, they do not share the collective authority and perspectives of those who serve at the state and local level in these areas.

Other states have established boards with varied expertise. For example, Georgia's Environmental Facilities Authority consists of three ex officio members, including the commissioner of community affairs, the state auditor, the commissioner of industry and trade, and eight members appointed by the Governor. The eight members are composed of municipal and county officials and members of the public. The Virginia Resources Authority consists of the state treasurer, the state health commissioner, the director of the Department of Environmental Quality and six members appointed by the Governor.

### **Key Program Elements**

We performed a limited review of the act to determine if it contained key elements necessary to a solid infrastructure financing program. As stated in our report, the key elements include:

- Appropriately defined and targeted funding priorities.
- Proper marketing efforts.
- Technical assistance from various interested state agencies.
- Coordination of various types of available financing.
- A credit analysis of each borrower.
- Monitoring of the borrower during construction of a project as well as throughout the repayment period.

The IFAA does contain language which addresses some of these elements. For example, the IFAA requires that the Division of Local Government assist the authority in analyzing and evaluating local governments, monitoring compliance by local governments, assisting local governments in applying for other state or federal aid and providing information to local governments on the authority's programs (§11-40-250).

However, regulations should be promulgated to ensure proper administration of the program including the duties and responsibilities of the staff. For example, the procedures used to analyze a borrower's historical and projected financial operations must be developed and consistently applied. As we note in this report, the failure to establish comprehensive regulations can impede the operations of a financing program.

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## Recommendations

- 17 The General Assembly may wish to consider amending the IFAA to set forth specific criteria to be met for entities applying for funding.
- 18 The General Assembly may wish to consider amending the IFAA to include membership from state agencies and other entities with expertise in the area of environmental infrastructure.
- 19 The Budget and Control Board should promulgate regulations and establish policies addressing the key elements of an infrastructure funding program. These should include at a minimum regulations addressing funding priorities, marketing, technical assistance, creditworthiness analysis, coordination of funding and monitoring.

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**Chapter 4**  
**Infrastructure Facilities Authority Act Review**

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# Appendices

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# Audit Scope and Methodology

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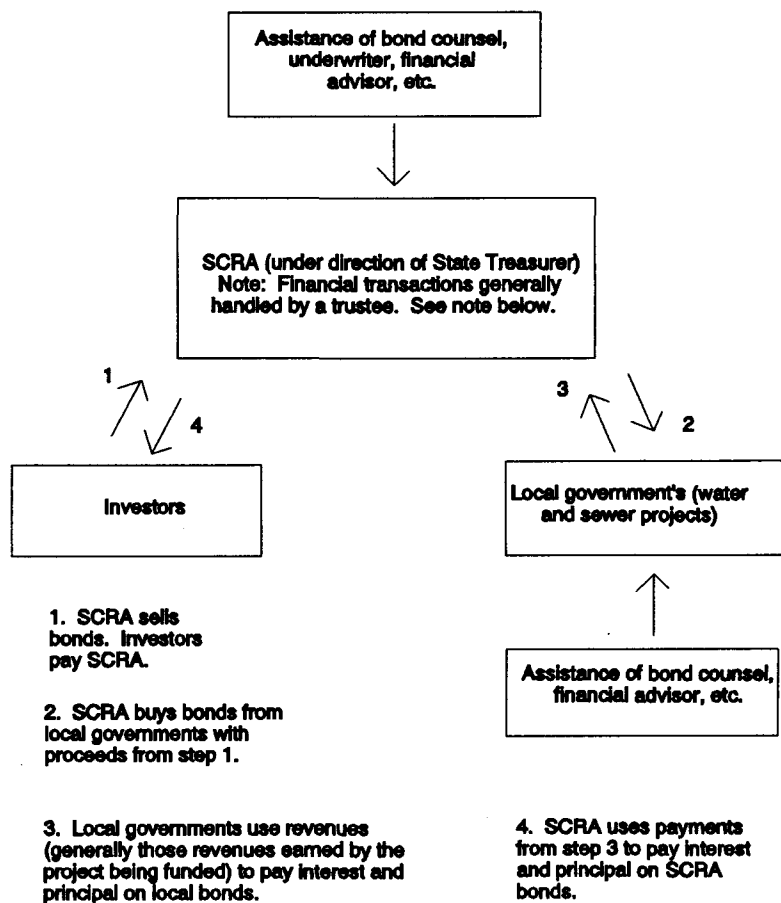
We reviewed the operation of the infrastructure funding program from its inception in 1988 through its latest activity in 1991. Primarily, our audit concentrated on the period from 1989 through 1991 during which three bond issues were negotiated. The program has been inactive since 1992.

There were concurrent audits and reviews of program participants being carried out by other agencies. These included a review of bond performance of selected borrowers by the Division of Local Government at the direction of SCRA. Additionally, ongoing examinations of New Ellenton were being conducted—a financial audit for FY 92-93 contracted out by the state auditor's office, an engineering review of New Ellenton's sewer system by the state engineer's office in conjunction with a contracted engineering firm, an investigation by the Federal Bureau of Investigation, and an investigation by the State Law Enforcement Division. There is also an ongoing lawsuit that involves the town of New Ellenton. We defined the scope of our review to avoid duplication with other reviews or issues currently in litigation.

JEDA records and bond documents were the primary evidence we examined in conducting our audit. We did not rely on computer-generated data. We examined a sample of JEDA's files in order to assess the completeness of information provided by applicants and the ensuing creditworthiness analysis performed by JEDA. We evaluated the adequacy of the information provided to the Water Resources Coordinating Council (WRCC) in its deliberations. We also examined documents of the local government division's review of borrowers' bond performance and information from other WRCC member agencies. We also reviewed promotional information on the bond program provided by JEDA during the marketing of the program. We reviewed minutes of board meetings for JEDA, WRCC, and SCRA from FY 88-89 through FY 91-92. We conducted interviews with JEDA officials and WRCC and SCRA agency staff. We interviewed officials with other states and the federal government. We interviewed an official with the rating company that rated the SCRA bonds and bond attorneys.

The primary criteria we used to measure the program's effectiveness were state statutes relating to the program. We obtained information from other states with similar programs and reviewed general literature in the field and reports from other states. We included all outstanding bonds issued by the program in our review, rather than use a sampling approach to accomplish our objectives. This audit was conducted in accordance with generally accepted government auditing standards.

# Bond Process Flow Chart



SCRA designates a trustee (a bank) to handle its financial matters. For example, for the 1990 and 1991 bond issues, the trustee was responsible for such activities as the collection and custody of local obligation payments, as well as payments to SCRA bond holders.

# SCRA Bonds

Participant	Issue Date	Amount Received
Aiken	Jun-90	\$1,965,000
Branchville	Apr-89	\$214,000
Dillon	Dec-91	\$1,615,000
Edgefield	Apr-89	\$1,848,000
Edgefield	Jun-90	\$1,165,000
Edisto	Apr-89	\$360,000
Edisto	Jun-90	\$460,000
Estill	Jun-90	\$3,390,000
Fort Mill	Dec-91	\$580,000
Georgetown	Apr-89	\$5,578,000
Georgetown	Jun-90	\$3,135,000
Hemingway	Apr-89	\$629,000
Isle of Palms	Dec-91	\$2,700,000
Lexington	Jun-90	\$2,525,000
McCormick	Jun-90	\$280,000
Mt. Pleasant	Jun-90	\$5,000,000
New Ellenton	Jun-90	\$5,025,000
Newberry	Dec-91	\$1,435,000
Pageland	Apr-89	\$1,367,000
Pageland	Dec-91	\$675,000
Ridgeland	Dec-91	\$650,000
Ridgeway	Apr-89	\$127,000
Saluda	Apr-89	\$922,000
Saluda	Jun-90	\$260,000
Santee	Apr-89	\$229,000
Santee	Jun-90	\$1,095,000
Summerton	Apr-89	\$99,000
Timmons ville	Apr-89	\$730,000
Turbeville	Jun-90	\$1,680,000
Varnville	Apr-89	\$333,000
Westminster	Apr-89	\$973,000
Williamston	Apr-89	\$941,000
Williston	Apr-89	\$123,000
Williston	Dec-91	\$285,000
<b>Total</b>		<b>\$48,393,000</b>

Amounts shown for participants in the 1989 issue do not include certain administrative costs totalling \$2,337,000.

Source: 1989, 1990 and 1991 Trust Indentures.



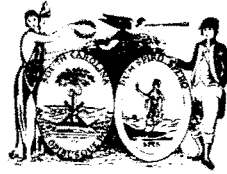
# Agency Comments

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# South Carolina Jobs-Economic Development Authority



Elliott E. Franks, III  
Chief Executive Officer

October 13, 1994

Ms. Cheryl A. Ridings  
Deputy Director  
Legislative Audit Council  
400 Gervais Street  
Columbia, South Carolina 29201

Dear Ms. Ridings:

Pursuant to our final exit review of the *Performance Audit of the South Carolina Resources Authority Infrastructure Funding Program*, we enclose our written comments which we wish you to publish as an appendix to the report. As required by LAC policy, our comments do not exceed ten pages.

If there are questions or if there is a need to confer with me, please so advise.

Sincerely,

A handwritten signature in dark ink, appearing to read "Elliott E. Franks, III", written over a circular stamp or seal.

Elliott E. Franks, III

EEF/dbr

c: Mr. Robert L. Mobley, Chairman  
Mr. Charles Kerekes  
Mr. David B. Roper, Jr.

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## Agency Comments

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As a preface to its response to specific allegations of the Legislative Audit Council (LAC), JEDA believes that it is important to comment on the framework of the infrastructure bond program and JEDA's role in the program. The program was conceived as an immediate response to reported estimates of \$200-\$300 million of infrastructure need across the State of South Carolina and an inability of local governments to obtain financing necessary to meet the need. The response came in the form of the South Carolina Resources Authority (SCRA) Act, establishing the program which is the subject of this audit. The original bill was introduced by the Governor, who believed that a quick and effective response to South Carolina's infrastructure needs was essential to the health and welfare of its citizenry and growth of its economy. When the legislation was conceived, it was understood that the participants would not be triple-A credits, but the legislation made provisions for the ultimate protection of the State's credit rating. Strength of the whole concept involved several levels of protection for the state. Should for any reason a unit of local government fail to make debt service payments under an SCRA bond issue, it was first provided, under Section 11-37-260, that "...the State Treasurer shall withhold from the local government sufficient monies from any state appropriation to the local government and apply so much as is necessary to the payment of the principal of and interest on the local obligation of the government." This section further provides "If the local government does not receive state aid in an amount necessary to repay the obligation, the Comptroller General may levy and require the applicable county treasurer to collect and remit to the Authority an ad valorem tax sufficient to meet the obligation." Working in conjunction with these provisions was the provision, under Section 11-37-190, that the General Assembly could appropriate funds to replenish the debt service reserve fund should it be depleted as a result of a local government's failure to make debt service payments as required. It was understood from the outset that such circumstances might well occur under a program providing weaker local governments with access to the State's borrowing power in the open bond market. But, it was believed that the funding need was urgent enough that such a program was necessary, and, ultimately, the State's credit was protected.

Furthermore, JEDA must state emphatically that the LAC's interpretation of whom this program was intended to help was far different from the interpretation of the Water Resources Coordinating Council (WRCC). In the LAC's evaluation of the role of the WRCC and the eight basic criteria established for funding priorities, it singled out three of the criteria, applied its own interpretation of the criteria, and arrived at the conclusion that the WRCC should have recommended only those projects from rural, less-developed counties, which had either been designated by DHEC as imminent health threat areas or were under DHEC-mandated tap moratoriums, and which had multiple funding sources. While the WRCC gave appropriate weight to the three criteria under which such projects would qualify for funding and recommended a number of applicants qualifying under those criteria, it also recognized that an important focus of the program, as specified by the SCRA Act, should be directed toward projects that would foster economic growth in any part of the state. The eight criteria and the implementation of them by the WRCC are addressed more specifically later in the body of JEDA's response. It should be noted here, however, that JEDA firmly believes that the WRCC, with staff support from JEDA, discharged its responsibilities under the SCRA Act in the true spirit of the Act.

JEDA also believes that the LAC has misconstrued JEDA's role and responsibilities under the SCRA Act, and never grasped the true accomplishments of JEDA and the WRCC under the program. JEDA's role and responsibilities are addressed in one sentence under Section 11-37-200 of the Act, stating simply "...The South Carolina Jobs Economic Development Authority shall provide the staff to receive, research, investigate, and process applications for projects made to the Coordinating Council and assist in the formulating of priorities." JEDA asserts that it discharged these responsibilities exceptionally well within the framework of the Act, and that it went even further with underwriting due diligence not specifically required along with a very proactive marketing program to educate local officials across the state about this new source of water and sewer financing.

### Chapter 2: The Roles of JEDA and SCRA

#### Credit Analysis (see pp.6-9)

**LAC alleges that JEDA focused its efforts only on the creditworthiness of applicants and essentially ignored the other seven criteria that the WRCC was required to consider in reviewing applicants to the program.**

To the contrary, all eight criteria were evaluated and discussed at every WRCC meeting, as detailed below.

**Regional development:** Most of the projects funded were of an urgent nature and could not be delayed until they could be done as a part of a regional system. This was addressed by JEDA and was discussed by the WRCC every time that projects were considered for funding. Another problem discussed in the WRCC meetings which hampered the development of regional water and sewer systems was the fact that the State of South Carolina is still largely rural and communities are separated by large areas that are unpopulated or very sparsely populated. The cost of developing regional systems under such conditions is prohibitive. A case in point is the sewer project for the Town of New Ellenton (1990), a small rural community in Aiken County, just the type of community targeted by the SCRA legislation. This

project originated with the Aiken County Public Service Authority's long term county-wide sewer plan, under which the entire county would eventually be served by sewer lines feeding into the Horse Creek Wastewater Treatment Plant. This treatment plant remains seriously under-utilized, but the cost of sewer lines and pump stations to pump wastewater from most of the county is not economically feasible. Aiken County Council in late 1989 targeted the New Ellenton/Cedar Creek area for sewer service because of its proximity to the Savannah River Site and the expansion plans of the Westinghouse Savannah River Corporation. (See Exhibit A) When Aiken County Public Service Authority determined that it would be cost prohibitive to pump sewage to Horse Creek WWTP (in excess of \$20MM in 1990), Aiken County urged the Town of New Ellenton to pursue a package plant/land application project as an interim measure to provide sewer to the area, with the promise of technical support from the Aiken County PSA and an expanded user base from existing and projected development outside the city limits of New Ellenton. After the project was started, an Aiken County referendum denied the County the right to implement county-wide sewer service under its long term plan, and essentially pulled the plug on the expansion of New Ellenton's prospective user base.

Development Potential: This was a major consideration with every project considered. Again, The Town of New Ellenton is a good example of a project which was considered by JEDA and the WRCC to be a somewhat undeveloped area with strong development potential. New Ellenton was legitimately on the verge of major development in 1990, with Westinghouse's plan to move high level operations to SRS. When the world situation changed so drastically with the collapse of the Soviet Union and the entire Eastern bloc., Westinghouse cancelled expansion plans for SRS and dealt a death blow to the Town of New Ellenton's development plans. (See Exhibits A-2 and A-3.) Another example is the Town of Santee (1990), a small rural community in Orangeburg County, again just the type of community targeted by the SCRA legislation. Although Santee has a history of poverty and very little in the way of job opportunities, its proximity to I-95 and Lake Marion, with all its recreational opportunities attracting tourists and retirees, has given the town excellent growth and development potential. Without the SCRA funding for its water system expansion, which was at capacity in 1990, the Town of Santee could not have accommodated the development it is currently experiencing, with a thriving new Shoney's restaurant creating 65-75 jobs and the new "Project Main Street" downtown development. Without SCRA funding in 1990 for the small rural Town of Estill's water and sewer system expansion to accommodate a new Federal prison, the Town could not have secured the commitment for the prison, which brought with it new jobs, income, tax revenues and opportunities for further growth and development. Likewise, the two small rural communities of Ridgeland and Turbeville were offered opportunities for growth and development with new jobs, income and the resultant tax revenues if they could expand their water and sewer systems to accommodate two new State prisons authorized by the General Assembly for construction on the outskirts of these two towns. The Turbeville expansion would serve an 808-bed prison facility and also would bring water and sewer to the intersection of I-95 and U.S. Highway 378, offering an opportunity for even further development and generating over 525 new jobs. The expansion of rural Edgefield County's water treatment and distribution facility to accommodate its development potential (See Exhibit B) could not have been accomplished without funding from the SCRA's 1990 Local Government Program Revenue Bonds. The SCRA also came to bat for the small rural Town of Saluda, providing funding in 1990 for the Town's wastewater treatment plant expansion, increasing capacity to allow for further growth within the region. (See Exhibit C)

Economic impact: As it relates to the opportunity for immediate results in the form of commitments for new industry, new jobs and increased income for communities, economic impact was one of the eight criteria which carried a high priority with JEDA and the WRCC. Commitments to two of these communities came via the General Assembly which, in its wisdom, approved the construction of prisons for Turbeville and Ridgeland. Based upon these actions, both communities proceeded to develop plans to construct and fund water and sewer projects which were prerequisites for the prisons. The prisons promised immediate job creation and income for these communities. The commitments would not have been secured by either of these towns had not JEDA and the WRCC recommended SCRA funding for these small rural communities through the 1990 and 1991 bond pools. The City of Dillon, another small rural community with town and county unemployment well above the State average and per capita income well below the State average, was able to secure a commitment from Perdue Farms, Incorporated, for a large chicken processing facility, projected to employ 500 local citizens. This new facility would also create income and employment opportunities for poultry farms in the area. This opportunity would have been lost had not JEDA and the WRCC brought the SCRA into the picture to participate in a funding package that included \$2,960,000 in grant funds from EDA, the Governor's Office (CDBG funds), the Division of Local Governments and SCANA. The economic impact of direct job creation also was a strong consideration in the WRCC's prioritizing of funding for the water and sewer system expansion of the Town of Estill. The Town had secured a commitment for the construction of a new Federal Prison which would create 250 new jobs for the citizens of Estill, but the commitment was contingent upon the Town's securing funding for a water and sewer system expansion. Funding from the SCRA's 1990 bond pool also enabled the Town of Estill secure a \$1,000,000 EDA grant from the U. S. Department of Commerce and a \$500,000 CDBG grant the Governor's Office to complete the funding for this project.

Local commitment and initiative: The program as designed included all of the identified state agencies involved with the certification or funding of water and sewer projects. Additionally, the Chairman of the WRCC was also the Chairman of the State Development Board and the Coordinating Council for Economic Development. Meetings were held by JEDA's program administrator and Executive Director with Messrs. Greer and Spivey, respectively, to review ways to improve coordination of funding with other sources. (See Exhibit D) JEDA additionally maintained a close working relationship with Pat Dixon, South Carolina's economic development representative with the Economic Development Administration (EDA) of the U.S. Department of Commerce, to assist in providing the local match required on all projects funded by EDA. The City of Dillon's 1991 bond issue was one project that involved a significant investment by EDA, matched with funds from an SCRA bond issue. The Town of Saluda was given special consideration and approved for funding in the 1990

bond issue so that it would not lose a 1988 EPA grant in the amount of \$357,000 which was due to expire if local matching funds were not secured. A \$200,000 grant from the Division of Local Governments of the State Budget and Control Board was also at risk if funding could not be obtained to complete the projects. This funding was completed with a \$75,000 CDBG grant from the Governor's Office and the 1990 SCRA bond financing (See Exhibit E). The Town of Ridgeland's proposed water and sewer system expansions to serve an 1100-bed State correctional facility presented an opportunity for the SCRA to participate with the State Revolving Fund (SRF), administered by the Division of Local Governments of the South Carolina Budget and Control Board, in funding this expansion. The Town of Ridgeland had already applied for SRF funding when JEDA became aware of the project, but the SRF could only fund wastewater projects, and JEDA presented the water system expansion project to the WRCC and secured its approval for funding in the SCRA's 1991 bond pool to complete the funding package. Since the Chairman of the WRCC was also Chairman of the Coordinating Council for Economic Development which administered highway set-aside funds, coordination of water and sewer project funding with complementary highway infrastructure projects was an opportunity to which JEDA remained alert and discussed with the Chairman and his Executive Assistant, Deborah Bass.

**Infrastructure need:** A large number of the projects funded were done so to solve specific identified infrastructure problems. As noted, only two of 19 funded after 1989 were under tap moratoriums, but four others were under DHEC consent orders to upgrade systems and two others were under DHEC order to comply with new EPA regulations. DHEC issues consent orders when a water or sewer provider demonstrates to DHEC that it is taking appropriate actions to upgrade a system and can serve to prevent DHEC from placing the system under a moratorium or to rescind a moratorium. For example, Edgefield County Water and Sewer Authority was operating under a DHEC moratorium when it applied for SCRA funding in October 1989. Although its water treatment plant normally pumped 1.8 to 2.0 MGD with a permitted capacity of 4.4 MGD, DHEC looked at peak day occurrences of 6.0 MGD and placed the system under a moratorium, prohibiting any new taps. With funding approved for a project to correct this problem, Edgefield could obtain a consent order from DHEC, rescinding the moratorium. (See Exhibit F) One other community operating its water system under a DHEC moratorium requested SCRA funding. This was the Town of Williston. (See Exhibit G) The Town's financial recordkeeping and the financial condition of the water system made this application difficult for JEDA to recommend to the WRCC. However, because of the Town's inability to comply with DHEC and come out from under the moratorium without SCRA funding, the WRCC granted conditional approval to Williston if it could comply with several conditions that would improve its creditworthiness. The Town complied and funding was provided by the SCRA in 1991. Also, Georgetown County Water and Sewer District was placed under a DHEC consent order subsequent to approval of its 9/12/89 SCRA application for system expansion, but prior to funding in June 1990. This consent order required the District to complete fluoride reduction measures to its water supply system by the summer of 1991, and the District requested by letter an increase in its SCRA funding in order to comply. Recognizing the urgency of this request, the WRCC acted promptly, granting approval on 5/10/90 and arranging for the increase to be included in the June 1990 bond issue of the SCRA. (See Exhibit H) As another example, the City of Isle of Palms was under DHEC consent orders for its water system and its wastewater treatment system, both of which had been acquired with consent orders from a private owner unwilling to spend the money to upgrade the systems. The City acquired the systems and applied for SCRA funding to complete the mandated projects. JEDA and the WRCC recognized that the City of Isle of Palms had a legitimate need qualifying for SCRA funding and that without SCRA funding, many citizens in the area would suffer hardships. (See Exhibit I) WRCC approved the project and recommended funding in the December 1991 SCRA bond issue. Also, JEDA presented the WRCC with a request for funding from the Town of McCormick to comply with a DHEC consent order to construct a facility to treat alum sludge and filter backwash water for its water system by 1/1/91. (See Exhibit J) McCormick is a small rural community that could not have complied with the DHEC order without funding assistance from the SCRA. The WRCC recognized this, approved the project and recommended it for funding in the SCRA's 1990 bond issue. The Town of Pageland was also under DHEC consent order to upgrade its water system with two alum sludge lagoons and applied for SCRA funding. Also included in Pageland's request was a wastewater treatment plant project to comply with new EPA regulations (See Exhibit K). Pageland was another small rural community needing SCRA funding for compliance with a DHEC order. This, too, received priority consideration by the WRCC and was recommended for funding in the SCRA's 1991 bond issue. Funding for compliance with new EPA regulations was also requested by the Town of Fort Mill and approved for SCRA funding in 1991. (Exhibit L) JEDA realized that all of these situations qualified a project to be prioritized under the criterion of Infrastructure Need and presented qualifying projects as such to the WRCC.

**Area economic need:** One of the first activities undertaken by JEDA in marketing the new program was a series of regionwide meetings with each of the ten regional planning councils and leaders from most of the communities they represented. These meetings were conducted throughout the week of January 31-February 3, 1989, and included presentations by Robert McMullan and Steve Klein of the investment banking firm of Donaldson, Lufkin and Jenrette and Sam Howell of the law firm of Haynsworth, Marion, McKay and Guerard. These grass roots meetings were conducted in order to fully explain the new infrastructure funding program to community leaders on their own turf. Furthermore, JEDA's program administrator participated in workshops and made presentations to the South Carolina Developers' Association, the South Carolina Conference of Black Mayors, the Finance Subcommittee of the Permanent Advisory Committee on Rural Economic Development. These presentations were made to impress upon participants how SCRA funding of water/sewer projects could assist rural communities with their development potential and play an active role in alleviating economic distress. JEDA's program administrator also attended many functions to meet with rural community leaders and discuss the SCRA program with them one-on-one. These functions included the State Development Board's Allies Meetings, meetings of the Municipal

Association and the Association of Counties, B. P. Barber and Associates' annual receptions for municipal delegates, annual Governor's Rural Leaders Conference. Contacts made at these meetings and functions were followed up with personal calls on the community leaders to further discuss infrastructure needs and funding through the SCRA program.

Program marketing was definitely targeted at less developed or rural areas of the state. While these were the areas experiencing the greatest degree of distress, and were the areas that could have benefited most from infrastructure improvements, these were also the areas most difficult to fund with SCRA bonds. Leaders of these communities were usually willing to wait and do nothing, hoping for grants that would not have to be paid back, or SRF funding which they expected to get at 2% interest. Many communities refused to consider SCRA funding which was always at market rates, indicating that their users couldn't afford the rate increases necessary to service the debt. The problem then and now in many rural communities is simply an inability of the user base, under reasonable fee schedules, to adequately meet required debt service on the high cost of infrastructure projects.

In addition to JEDA's 1989 survey of infrastructure needs, and subsequent one-on-one followup on all responses, JEDA's program administrator also made a very thorough analysis of the results of an ACIR Statewide Capital Needs Survey and made numerous calls on rural community leaders who had indicated a need for infrastructure projects. Furthermore, Meetings were held with all identified law firms whose attorneys represented communities in the issuance of water and sewer bonds, i.e., McNair Sanford, Sinkler Boyd, Nelson Mullins Riley & Scarborough, and Haynsworth Marion McKay & Guerard. JEDA's program administrator also initiated meetings around the state with engineering firms active in water and sewer projects, including B. P. Barber & Associates, Sirrine Environmental Consultants, Inc., Davis & Floyd, Engineers, Wiedeman & Singleton, Dunn & Associates, Rogers & Calcutt Engineers, Inc., D. C. Barbot & Associates, Inc., Gary Hubbard, P.E., Harwood Beebe Company, Inc., A. W. Shoalbred, P.E., Hussey, Gay, Bell & DeYoung, Site Consultants, Inc., CH2M Hill, Cantelou Associates, Inc., and Leon Campbell & Associates, Inc.

Public health and welfare: This was always a consideration in JEDA's analysis and when the WRCC reviewed projects for funding. For example, New Ellenton had serious problems with septic tanks that didn't drain properly because of unsuitable soil conditions (particularly troublesome in wet weather), as well as some instances of surface discharge of raw sewage. Also, Georgetown County borrowed to provide sewer service to developments which were on septic tanks that didn't drain properly or which were contaminating wetlands. The Town of Isle of Palms had acquired private water and sewer systems which were contaminating shellfish and surrounding wetlands and were under DHEC consent orders to correct permit violations and to comply with the Clean Drinking Water Act. All of these projects were given priority consideration because of the severity of the health problems presented by the situations.

Creditworthiness: The financial soundness of the project and the availability of other funding were always strong considerations of JEDA and the WRCC in evaluating projects for funding through the SCRA bond program. However, the WRCC consistently evaluated each applicant's financial condition in relationship to the other seven criteria, and in many cases made special efforts to give applicants guidance in improving their financial condition so that the projects could be funded. JEDA doesn't claim infallibility with respect to the credit analysis approach it developed for the program. Experienced and competent lenders will all document the fact that there is no perfect system, nor a system that is free of all error on occasion. However, the credit review system was developed through consultation with the Virginia Resources Authority, a very active and effective infrastructure bond bank, and Donaldson, Lufkin and Jenrette, a successful investment banking and underwriting firm with vast infrastructure financing experience. Further validity of the quality of the JEDA review system was provided through consultation with Loren Carlson of Manufacturers Hanover, another successful investment banking firm and a firm knowledgeable about South Carolina.

JEDA made no assumptions that its initial system of reviewing and analyzing applicants was the best it could be. Improvements were constantly being made to the evaluation process, to the information presented to the WRCC and to the information requested of the applicants. This is a natural evolutionary process with any new program. However, JEDA's analysis of historical financials and projections was always thorough. In performing its independent evaluation and analysis of the revenue projections provided with the applications, JEDA compared them against the historical performance of existing systems, considered current and proposed rate increases, growth projections based on expansion of the user base, and other assumptions presented by the system managers, the consulting engineers, or both. Projections that did not pass muster with these evaluations were discussed thoroughly with the system managers or consulting engineers and typically returned to the drawing board. Because JEDA files are not documented with staff-prepared projections based on historical data for comparison with the actual projections, does not mean that quality evaluations and comparisons with historical data were not performed. JEDA began administering the program with very limited funding and did not have the luxury of computer programs for preparing such projections. JEDA's number-crunching was done with calculators, pencils and paper, and the work papers were rarely retained once the bonds were issued.

In addition to financial statements and projections, JEDA also carefully considered the system's rate history and the authority to raise rates, which was information provided in each application. JEDA also considered the economic environment in which the system operated, as evidenced by its comments to the WRCC, the information provided to the WRCC regarding area industries, the tax base and employment. JEDA further analyzed system operations and finance, as evidenced by information provided to WRCC regarding capacity of the system, the largest users, bad debt history, and previous financings. Although refinements were made to the system, the basic analysis was thorough from the start.

As to the allegations that JEDA's loan files lacked essential documentation for eleven of the thirty-four projects, we must disagree. The chart on page 8 of the LAC report highlights a number of areas of missing documentation which we will address. Turbeville 1990 was cited for a missing Schedule D - Financial to the application. While this particular two-page form was missing from the application, the key information requested on the form was provided in other schedules and attachments accompanying the application. Turbeville 1990 was also initially cited for not having current interim financial statements and no operating budget for the current fiscal year. Interim statements were unnecessary since the application was received in October 1989 with a copy of the June 30, 1989 audited year-end financial statements which were less than four months old. Furthermore, an operating budget for the current fiscal year was in file and was provided to the LAC as Exhibit R. Georgetown 1990 was cited for not having current interim financial statements or de-tailed projections prepared or approved by the consulting engineer. Interim financials were unnecessary since the application was submitted September 12, 1989, with a June 30, 1989, audit report, less than three months old. As to the consulting engineer's approval of projections, this was inappropriate since Georgetown sought funding for a number of small projects handled by different engineers. Furthermore, management of Georgetown County Water and Sewer Authority was well qualified to prepare their own financial projections. The Finance Manager, LaDain Port, had a B.S. degree from the University of South Carolina, had completed several advanced accounting programs, and had managed the Authority's Finance Department since 1981. He operated under the direct supervision of the Executive Director, Robert E. Barker, who received his B.S. degree from Clemson University in 1970, his M.S. degree from Pennsylvania State University in 1971, had completed several advanced training programs, and had 13 years experience in water and wastewater management, having managed the Georgetown County Water and Sewer Authority since 1982. Mr. Barker also had direct supervisory responsibilities over the Engineering Manager, who was a professional engineer, and over the Superintendent of Operations.

Edgefield 1990 was cited for missing interims, a missing budget, and missing projections. Interims were unnecessary since the application was submitted in October 1989 with a June 30, 1989, audit report, less than four months old. True, there was no budget and no projections, however historical debt service coverage was very strong, and there was an urgent need for a funding commitment because the system was operating under a moratorium imposed by DHEC. (Refer back to Exhibit F) Subsequently, Edgefield County Water & Sewer Authority provided projections prior to receiving funding from the SCRA. They were included in the Official Statement and were prepared and signed by the administrator since the funding was for more than one project with more than one engineer. (See Exhibit S) Dillon 1991 was cited for missing projections prepared/approved by the consulting engineer. The file contains summary projections signed by the consulting engineer, but not detailed projections. Dillon's engineer had initially submitted more detailed projections of revenues and expenses, and the debt service coverage worksheet for these pro formas remains in the file. Prior to submission of the analysis to the WRCC, however, the engineer discovered that some of his assumptions were incorrect, and the projections were replaced by the summary projections found in the file. The first projections were destroyed when the permanent files were set up, since they had been superseded and no longer applied. Although the projections found in the file are not in detail, they are supported by the engineer's assumptions and signed by the engineer. (See Exhibit T)

**Staffing:** JEDA's staffing of the SCRA program by one employee was by negotiated agreement between the Governor's Office staff (Dr. Harry Miley) and Representative Robert McLellan, then Chairman of the House Ways & Means committee. This agreement provided JEDA with emergency funding and was critical to program implementation, since the legislation did not provide funding for JEDA's administration of the program. Rather, actual expenses incurred were to be reimbursed not to exceed \$100,000 per calendar year. Funds for reimbursement, however, were solely dependent upon bond proceeds being available. In management's judgement, the program employee possessed the necessary academic preparation (MBA), together with relevant banking experience essential to successful administration of this program. All work performed was monitored and reviewed carefully by management.

**Conformity with Lending Policy:** Infrastructure financing is uniquely different from other JEDA lending. As pointed out by Tom Fink of the Public Finance Department of Chemical Securities, Inc. "...there is a fundamental difference between the credit review criteria used for a private, commercial loan and that used for a debt secured by a municipality." (See Exhibit Q) For this reason, JEDA's general lending policies are largely inapplicable. These lending policies are directed at JEDA's commercial lending business, and the various levels of review and supervision utilize the commercial loan experience of JEDA's loan staff and loan administration staff. As further stated by Mr. Fink, "...it would be highly unlikely for a commercial credit officer to have the expertise necessary to evaluate a municipal credit, and vice versa." Aside from the program administrator, JEDA's Executive Director is the only member of the staff or management team acutely familiar with municipal bond financing for water and sewer projects. The program administrator was closely supervised by the Executive Director, and his analysis and evaluation of each application was carefully reviewed and discussed with the Executive Director prior to their review and discussion with the Chairman of the Water Resources Coordinating Council and subsequent presentation to the WRCC for consideration. Furthermore, JEDA's Loan Committee is a committee of the JEDA Board of Directors, functioning on behalf of the JEDA Board to review and approve commercial loans and small issue IDB's (Industrial Development Bonds) within certain parameters. Neither the JEDA Board nor its Loan Committee had any direct responsibilities for review or approval of infrastructure applications. The JEDA Board's responsibility was to assign qualified staff to administer the program and report directly to the WRCC on matters relating to the infrastructure bond program.



## STATUS OF DEBT OBLIGATIONS (See pp. 10-13)

This section addresses the performance of the infrastructure bond pool participants and their compliance with the provisions of the local bond ordinances after the bonds were issued. Although JEDA had no responsibility or authority concerning the participants at this point, it appears that some comments are warranted. There is every indication that most of the participants in the SCRA's three bond issues received no oversight, guidance or monitoring from anyone at the state level from the time the bonds were issued through year end 1993. It is not unusual that LAC's desk review for fiscal years 1992 and 1993 found eight borrowers not in compliance with the provisions of the local bond ordinances concerning debt service coverage. We must be reminded here that the legislation which created the infrastructure bond financing program specifically targeted small rural communities that typically had difficulty obtaining financing for water and sewer projects. It stands to reason that if they needed assistance in qualifying and obtaining the financing, then they would also need some degree of assistance and monitoring to comply with the ongoing requirements.

We also wish to comment on the following statement by the LAC regarding reserve accounts: *"By not including any provision for reserves, our calculation of debt service coverage would be overstated and, therefore, probably overly optimistic."* Note that the 120% coverage requirement is intended to cover 100% of debt service with a 20% buffer to cover reserve funding and contingencies. This is a standard in the industry. Allowances for reserves should never be treated as operating expenses when calculating debt service coverage. Furthermore, any system whose debt service coverage goes much beyond 120% can be assumed to be overcharging its users.

## STATE FUNDS USED TO PAY LOCAL DEBT--New Ellenton (See pp. 15-23)

**Revenues and User Projections Overstated:** In commenting about the overstatement of projections of revenues and users, the LAC Audit Staff criticized JEDA on page 17 of its Report to the General Assembly for not requiring that the Highway 19 corridor, beyond the town limits of New Ellenton, be eliminated from the project. It should be noted, however, that, in the judgement of the Aiken County Council, this rapidly growing Highway 19 corridor was a priority growth area of Aiken County and the availability of sewer service to this corridor would be "...an enhancement to economic growth in the county." This was attested in Resolution No. 89-12-455 passed by Aiken County Council on December 19, 1989. It should be noted, also, that the service area for the town's water system extends well beyond the town limits and it was anticipated that the town's sewer service area would do likewise. However, several months after the bonds were issued in June 1990, but before the New Ellenton project had begun, Aiken County held a referendum for county-wide sewer service and the referendum was defeated. This referendum would have authorized mandatory taps for anyone in the county with access to a sewer line. This defeat of the referendum, in itself, would not have been cause to halt the Highway 19 corridor phase of the project, but would have presented a golden opportunity for an effective marketing campaign to sell the benefits of sewer service to the businesses and homeowners already located in this corridor. It is also surprising that this referendum defeat did not elicit some attention and support from those who were responsible for monitoring the SCRA projects at the state level. One should not lose sight of the fact that this project was prioritized by the WRCC under the criteria of Regional Development and Development Potential, and at that time these criteria were still valid for this project (see p.46).

**JEDA's Application Review:** It is true that there is "...no evidence that the information presented to the WRCC mentioned that the treatment site was to be on private land." However, JEDA was informed in late December 1989 by Aiken County officials that it was their intent to acquire a treatment plant which was already permitted and under construction by a private developer to serve the New Ellenton/South Aiken area. Furthermore, the resolution passed by the New Ellenton City Council indicated the decision of the City Council to improve its Commission of Public Works by "...acquiring...an interim wastewater treatment plant located on lands owned by Cedar Creek Properties, Inc." This was understood to mean that the plant and land were being acquired by the City. During the application review and prior to the issuance of bonds by the SCRA for this project, JEDA had no knowledge of a contract between Cedar Creek Utility and the City dated April 16, 1990.

As charged by the LAC, there is also no evidence that JEDA made the WRCC "...aware of the relationship of the project engineer with Cedar Creek/Banks Mill." This is because JEDA knew only that the engineer for Cedar Creek, had obtained the NPDES permit for a private wastewater treatment plant, which would now be acquired by the City of New Ellenton, and that he would continue the project as engineer for the City of New Ellenton. Based on the information presented to JEDA in the March 8, 1990 letter referenced by the LAC, there was no indication of any impropriety or conflict of interest at that time. Not until September/October 1992 did JEDA learn that the project engineer was more than the engineer for Cedar Creek, and that he was a partner in Banks Mill Partnership which owned Cedar Creek Properties, Inc. In September 1992, upon receipt of verbal information regarding alleged improper activities connected with the New Ellenton project, JEDA's Executive Director met with the Executive Director of the Lower Savannah Council of Governments who volunteered to provide JEDA with the information he had obtained. Following this meeting, the Executive Director of the Budget and Control Board, Dr. Luther F. Carter, was notified and he met with these two gentlemen to discuss the allegations. Following this meeting, JEDA's program administrator spent five workdays in the New Ellenton/Aiken County area in late September and early October of 1992, meeting with various officials and reviewing all identified project records to ascertain any discernible violations

or misappropriation of funds. Upon completion of this fact finding mission and evaluation of the information found, a report was prepared and submitted to Dr. Luther F. Carter, Executive Director of the Budget and Control Board. Although the Cedar Creek/Banks Mill relationship with the project engineer was turned up, there was still no obvious evidence of any wrongdoing. (See Exhibit M)

As to the LAC Audit Staff's statement that it "...found no evidence that JEDA or WRCC ever questioned the number of sewer system users projected in the preliminary engineering report, although, as previously discussed, these figures were grossly overstated...", we cannot deny that there was no written evidence in the JEDA files regarding this. However, we can assert that the preliminary engineering report, including the number and location of the projected system users, was the subject of a lengthy meeting with the consulting engineer, the Mayor and JEDA's program administrator during the application and evaluation period. The user projections were presented as reasonable and even conservative projections, considering the significant growth forecast for the area in connection with the plans Westinghouse had voiced for the Savannah River Site and ancillary development of research and development facilities. At the time, no one at the City, County or State level seemed to question that this growth would happen, but we all now know what actually happened. This should remind everyone involved with this project how much clearer the vision is when one is using "hindsight" rather than "foresight." This project was viewed as an ideal response to the General Assembly's charge to the WRCC to use infrastructure as a proactive tool by providing infrastructure funding for areas with development potential. The WRCC could also see this project spurring development and having a very positive economic impact on a town that had heretofore experienced very little economic development, not to mention eliminating health hazards already mentioned.

Use of Sewer Bond Funds for Other Purchases; Former Mayor Indicted for Fraud, Embezzlement: As to the recent discoveries of misuse of sewer bond funds and the indictment of the former Mayor for fraud and embezzlement, JEDA firmly believes that no amount of due diligence, investigation or evaluation can prevent or deter a public official from perpetrating a crime. Even the most experienced lenders sometimes fall prey to fraud and embezzlement. (See Exhibit N)

No Controls Over Disbursement of Funds: With municipal bond financing, oversight and accountability for the bond construction funds are typically the responsibility of local officials and the consulting engineer, in compliance with the bond trustee's disbursement requirements. This is ordinarily sufficient, unless the criminal factor enters the picture.

The Referendum Issue: JEDA relied on the local bond counsel's legal opinion that a referendum was unnecessary for the New Ellenton sewer project. When the final bond ordinance was passed, indicating that there was an existing sewer system, JEDA was totally unaware of this action. This stage of the program was under the control of the State Treasurer and the bond counsel appointed by the SCRA. This should have raised a "red flag" that something was awry, and instituted at least further discussion between the SCRA's bond counsel and local bond counsel.

As to the objections raised to the Governor's office by a group of citizens prior to the issuance of the bond, JEDA investigated the allegations. Based on letters from Mayor Shaw, John Harte, the Town Attorney, and Frieda Walker of the Aiken County Public Service Authority, it was determined that the objections did not speak for a significant number of the residents of New Ellenton, nor did they accurately address any of the issues involved in the bond financing. (See Exhibit O)

#### STATE FUNDS USED TO PAY LOCAL DEBT--Ridgeland and Turbeville

(See pp. 23-24)

The facts of these two projects are very clear. The General Assembly authorized construction of new prisons in Ridgeland and Turbeville. The water and sewer projects were a prerequisite of construction and revenues to be generated from the Department of Corrections would well support debt service on the bonded debt. The WRCC approved funding based on this information and the SCRA funded the projects. Then funding for the prisons was delayed and the General Assembly recognized its responsibility for debt service on the SCRA bonds, which had been issued in reliance on commitments authorized by the General Assembly.

### **Chapter 3: The Role of WRCC**

#### PROJECT CRITERIA (See page 25)

The eight criteria outlined in the SCRA Act and reiterated on page 25 of the LAC Draft Report were discussed at length in JEDA's comments responding to the LAC's evaluation of its performance in relation to these criteria.

#### FUNDING GUIDELINES (See pp. 26-27)

The LAC Audit Staff reports that the WRCC did not fund projects on the basis of the eight criteria referenced above. This is absolutely false, as evidenced by JEDA's comments under Chapter 2 and the Exhibits referenced in those comments. JEDA believes that the record demonstrates that JEDA and the WRCC acted responsibly in meeting the legislative intent of the program to promote the general health and welfare of all South Carolinians and to act as an incentive to foster economic growth, particularly in the rural, less-developed areas



of the state. LAC states that the WRCC simply approved all applicants brought before them for consideration. What the LAC overlooks are the multitude of communities in the rural, less-developed areas of the state (See Exhibit U) that JEDA tried to bring to the WRCC, but which could not be persuaded to request funding from the SCRA for their water and sewer needs. Those communities who did apply through JEDA and the WRCC for SCRA funding represented valid needs which qualified for funding under one or more of the criteria established by the General Assembly in the SCRA Act.

The LAC makes reference to the *Operating Guidelines for Receipt, Rating and Ranking* which were presented by JEDA to the WRCC at one of its early meetings. Their attempt to find merit in these *Guidelines* is totally unfounded. The Guidelines were simply dropped because it was determined, in individual discussions with members of the WRCC, that they were far too bureaucratic and would seriously hamper the flexibility necessary to operate efficiently and achieve the intent of the program. The existing Federal and State sources of infrastructure funding were good examples of programs bogged down in bureaucratic red tape. This new program needed to be different and needed to emphasize flexibility and efficiency. JEDA believes that the statistics regarding the criteria met by the projects funded by SCRA speak well for the performance of JEDA and the WRCC. Not all of the funding was focused in one area, or on one or two criteria, but reached all of the established criteria. (See Table below)

CRITERIA MET BY SCRA PROJECTS AS EVALUATED BY WRCC FOR JUNE 1990 AND DECEMBER 1991 BOND ISSUES																	
PARTICIPANT	ISSUE DATE	CRITERIA								PARTICIPANT	ISSUE DATE	CRITERIA					
		1	2	3	4	5	6	7	8			1	2	3	4	5	6
Aiken	Jun-90	X	X	X					X	Mt. Pleasant	Jun-90	X					X
Dillon	Dec-91		X	X	X		X		X	New Ellenton	Jun-90	X	X			X	X
Edgefield	Jun-90	X	X			X	X		X	Newberry	Dec-91	X	X			X	
Edisto	Jun-90					X		X	X	Pageland	Dec-91					X	X
Evell	Jun-90		X	X	X		X		X	Ridgeland	Dec-91		X	X	X		X
Fort Mill	Dec-91					X	X		X	Saluda	Jun-90		X		X		X
Georgetown	Jun-90	X	X			X		X	X	Santee	Jun-90		X			X	
Isle of Palms	Dec-91					X		X	X	Turbeville	Jun-90		X	X	X		X
Lexington	Jun-90	X	X						X	Williston	Dec-91					X	X
McCormick	Jun-90					X	X		X								

**KEY TO CRITERIA:**

1 - Regional Development	5 - Infrastructure Need
2 - Development Potential	6 - Area Economic Need
3 - Economic Impact	7 - Public Health and Welfare
4 - Local Commitment and Initiative	8 - Creditworthiness

#### TECHNICAL ASSISTANCE (See pp. 28-29)

In response to the LAC's comments regarding the usefulness of the Geographic Information System (GIS) in evaluating applicants, JEDA wishes to note that the system was used as soon as the data was loaded and reliable, but that was not achieved until after the last bond issue of the SCRA in 1991. From the time the GIS was first introduced by Sena Black of the State Development Board (now the Department of Commerce) to the WRCC at its 11/20/89 meeting, JEDA monitored the progress of Ms. Black's division in loading the databases. As soon as the databases were relatively complete and reliable, JEDA obtained reports and maps and used them religiously in marketing the infrastructure funding program. They were quite helpful to use in discussing new projects with system managers, but the WRCC never had the opportunity to use them in evaluating applications.

#### APPLICANT SUMMARY (See page 30)

The LAC criticizes JEDA for using the 1989 Applicant Summary to present information to the WRCC for five participants in the 1990 bond issue. JEDA acknowledges that the Applicant Summary developed later was more comprehensive and more useful to the WRCC in evaluating applicants. However, JEDA must again emphasize that this was a new program which initially had some imperfections and was constantly being improved upon. As stated before, this is a natural evolutionary process with any new program. JEDA would not have been discharging its duty to the WRCC and to the General Assembly if it simply put all funding requests on hold while it tried to develop the ideal Applicant Summary.



JEDA challenges the LAC's allegation that JEDA did not direct its marketing efforts for the 1990 and 1991 issues at infrastructure projects the program was intended to serve. JEDA wishes to emphasize at this juncture that the WRCC did not interpret the SCRA Act in exactly the same fashion as the LAC seems to at this time. The WRCC did not believe that the program was limited to rural, less-developed areas, although it gave priority consideration to applicants from such areas. As already noted earlier, the extra efforts made by the WRCC to provide funding assistance to the towns of Williston and Santee speak directly to this. As to the LAC's comments about JEDA's inadequate records of responses to JEDA's 1989 needs survey, JEDA maintained the individual responses, summarized them and reported them to the WRCC. These records were made available to the LAC audit staff. Also, contrary to the statement by the LAC that "...we could not confirm any relationship between the responses...and the applicants or what, if any, follow-up was performed," JEDA's records documented that out of 24 communities which responded with identifiable needs, 11 were actually funded, although JEDA individually called on each one. Note also that of the 24 respondents, at least 20 could be considered small and rural. JEDA proceeded from this point to meet with each of the ten COG directors across the state to develop additional leads on community infrastructure needs with their regions. As earlier noted, JEDA actively focused its marketing efforts on the rural areas of the state, but not to the detriment of the other areas in the state.

**COORDINATION OF FUNDING** (See pp. 32-33)

The LAC Audit Staff is correct in stating that "...the WRCC established no formal procedures for coordination of funding." The WRCC chose not to expend its energies in developing formal procedures before it had an opportunity to see how this new program could be coordinated with other infrastructure funding sources. However, this does not mean that the WRCC failed to coordinate funding with other sources. JEDA and the WRCC made every attempt possible to coordinate funding with other available sources, which included the Economic Development Administration of the U.S. Department of Commerce (EDA), Farmers Home Administration (FmHA), the Division of Economic Development of the Governor's Office (DED) which administers Community Development Block Grants(CDBG), and the Division of Local Governments (DLG) of the Budget and Control Board which administers a small fund of state grants, and the State Revolving Fund (SRF). While JEDA was able to coordinate several funding packages with EDA, i.e., Dillon, Estill and Turbeville, EDA's funding was very specialized and targeted a limited market. These three projects also received funding from DED grants, while Dillon and Turbeville also received DLG grants. As already noted, Saluda CPW was funded by SCRA in coordination with an EPA grant, a DLG grant, and a CDBG grant. The Town of Ridgeland was funded jointly by the SCRA and the SRF. Due to the fact that FmHA is a lender of last resort, it is impossible to coordinate funding with it. Furthermore, JEDA found it difficult to coordinate funding with the SRF, which often seemed to take a competitive posture with the bond program, but it made every effort to do so. (Refer back to Exhibit D) Any serious effort of the WRCC to coordinate funding sources ended with the untimely death of Currie Spivey in 1991.

**NOTE:** Please note that the Legislative Audit Council would not allow the space necessary for publication of the Exhibits referenced by JEDA in its response, however, JEDA chose to leave the references to Exhibits intact and will make these referenced exhibits available to interested parties.

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